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**Associate Editor:** Julio Araujo Carneiro da Cunha  
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## Activism and the Request for Establishment of the Fiscal Council: influence of Monitoring, Performance, and Ownership Structure

### ABSTRACT

**Objective:** This paper investigates if indicators of monitoring, ownership structure, and performance are related to the likelihood of a Brazilian firm to receive formal requests to establish a Fiscal Council (FC). Such a request may be understood as a manifestation of activism since it indicates the shareholders' willingness to increase oversight over the management.

**Method:** Firms that received formal requests to establish Fiscal Councils and firms without FCs were observed between 2010 and 2016. The two groups were compared, and logit models were employed to analyze the variables related to the odds in favor of the event.

**Originality/relevance:** The research contributes to the emerging literature on activism in Brazil and it is a pioneer in the investigation of a governance body, unusual in the global scenario.

**Results:** The likelihood of the event is positively related to board size and negatively related to the presence of an audit committee. The association between performance and the likelihood of receiving a request is negative, in line with evidence from the literature. The request to establish a FC is more likely to occur in firms with shareholders' agreements, which suggests a negative reaction to this mechanism by the shareholders concerning the articulation of control.

**Theoretical/methodological contributions:** The results contribute to the academic debate about how different corporate governance mechanisms complement or substitute each other and the drivers of shareholders' activism.

**Social and managerial contributions:** The findings may help firms to anticipate this type of demand, which is facilitated after the implementation of the distance voting.

**Keywords:** activism; fiscal council; audit committee; shareholders' agreement; minority shareholders.

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Patricia Maria Bortolon   
Universidade Federal do Espírito Santo (UFES),  
Espírito Santo, Brasil  
E-mail: patricia.bortolon@ufes.br

Layziane Souza Silva   
Universidade Federal do Espírito Santo (UFES),  
Espírito Santo, Brasil  
E-mail: layzianesilva@gmail.com

Lucas Ayres Barreira de Campos  
Barros   
Universidade de São Paulo (USP), São Paulo,  
Brasil  
E-mail: lucasbarros@usp.br

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## 1 INTRODUCTION

The activist shareholder is recognized as the one that, when unhappy with some aspect of the company, tries to induce changes without altering the company's control (Gillan & Starks, 2007). Shareholders' dissatisfaction is expressed in different ways, including voice (activism) and exit (selling shares) (Hirschman, 1970). Researches show that before assembling in meetings, some shareholders seek direct interactions with the firm, performing hidden movements that are difficult to identify. Thus, the activism observed in shareholders assemblies is only part of the activism initiatives occurring within a firm (Goranova & Ryan, 2013).

Before deciding to engage in activist initiatives, shareholders analyze and monitor the investee company. The attempt to interfere in the firm's management becomes a mechanism of corporate governance as it points out faults and responds to agency conflicts existent within the companies (Gillan & Starks, 2007; Schaefer & Hertrich, 2011).

According to Karpoff (2001), the increase in the frequency of activist initiatives coincides with the increase in the participation of institutional investors in the firms' capital. The reproduction of an index or regulatory restrictions may limit diversification, leading this type of investors to try influencing the companies, seeking better performance (Monks & Minow, 1992).

The international literature on activism focuses on Anglo-Saxon countries, characterized by dispersed ownership and control, where agency conflict occurs between shareholders and managers. The concentration of control entails incentives to participate in the management. The result of this phenomenon is the type of agency problem observed in developing countries and continental Europe, which is the potential expropriation of the minority shareholders by the controlling shareholders (Aldrighi, 2014; La Porta, Lopez-De-Silanes, & Shleifer, 1999). In these contexts, the minority shareholders face significant challenges to exercise influence.

Vargas, Bortolon, Barros, and Leal (2018) use an index to show that shareholder activism is still incipient in Brazil, although it has increased in the period researched. Among the evidence mapped, the authors identified the formal request for the firm to establish a Fiscal Council (FC) and the election of members to form this committee. The FC is responsible for monitoring administrative acts and issue opinions on the financial statements that are examined by the auditor. Article 161 of the Brazilian Corporations Law states that companies shall have a FC and the firm's bylaws shall determine the committee operation, either permanently or in the years requested by the shareholders<sup>1</sup>. The law also provides that minority shareholders have the right to elect a member and its substitute, making it easier for these shareholders to be represented in the FC than in the firm's board.

In Brazil, when requesting the establishment of a FC, shareholders influence the firm's governance structure and communicate to the company the desire to expand monitoring. This movement is, therefore, a manifestation of shareholders activism. This research seeks to investigate the characteristics related to this request. As the FC's role involves issuing an opinion (and not deliberating) after observing reports and ex-post facts, the characteristics that represent the tasks of internal or external monitoring are emphasized in this study. The research takes into consideration characteristics such as the independence, size, and frequency of board meetings, since the literature suggests that they are related to the board's decision-making, which may influence the quality of monitoring (Anderson, Mansi, & Reeb, 2004; Hermalin & Weisbach, 2001; Vafeas, 1999). In addition, external monitoring is observed

through the quality of independent auditing and coverage by market analysts (Adams & Neururer, 2019; DeFond, Raghunandan, & Subramanyam, 2002).

The study explores the ownership structure and performance, as well as the concentration of control, a characteristic of the Brazilian context that represents a greater incentive for major shareholders to engage in monitoring, which is positive. However, this engagement may discourage initiatives by minority shareholders, who see little chance that their proposals will be accepted (Leal & Carvalhal da Silva, 2006; Shleifer & Vishny, 1986). Shareholders' agreements are another feature that deserves investigation, since the control articulation provided by the agreements may represent negative effects on activism (Carvalhal, 2012; Gelman, Castro, & Seidler, 2015). The international literature often recognizes institutional investors as important management monitoring players (Gillan & Starks, 2000; Guercio & Hawkins, 1999). In Brazil, Punsuvo, Kayo, and Barros (2007), and Sonza and Granzotto (2018) found a negative relation between the participation of pension funds and, respectively, the quality of governance and the performance of investees companies.

International literature points out that poor performance motivate activism (Ertimur, Ferri, & Muslu, 2011; Karpoff, Malatesta, & Walking, 1996). In Brazil, Vargas (2013) found a negative relationship between performance and a broad index of activism, and Guimarães, Leal, Wanke, and Morey (2018) suggest that activists tend to choose underperforming companies.

This article contributes to the scarce literature on activism in Brazil. The requests for establishing a FC have gained more relevance after the institution of distance voting, as provided by the instruction from the Brazilian securities authority CVM 561/2015 (CVM, 2015). In the distance voting process, the inclusion of an option requesting the establishment of the FC is mandatory, and this request facilitates the manifestation of the shareholders regarding this issue. Understanding the factors that lead to this attitude of shareholders can indicate ways for firms to anticipate this demand, improving communication and meeting shareholders' expectations.

## 2 LITERATURE REVIEW AND HYPOTHESES

In corporations, the separation of ownership and control establishes that shareholders can choose the firm's board members. Board members should act in the best interests of shareholders and failing to play this role motivates activist initiatives (Gillan & Starks, 1998).

According to Gillan and Starks (2007), activism is a response to the agency conflicts existing in companies. Smith (1996) associates its growing importance since the 1990s in the US, with the reduction of activity in the hostile takeover market and the consequent weakened importance as a disciplining element of management. In addition, the author indicates that the growth of institutional investors' participation contributes to increasing activism.

The legal environment is a relevant factor for the development of activist initiatives. The regulation establishes, for example, the division of power between the board and the shareholders' assembly. The regulation also provides when the management is required to take action or not. In the US, for example, voting results on executive compensation became binding only as of 2011 with the Dodd-Frank Act, after the 2008 financial crisis (Thomas, Palmiter, & Cotter, 2011).

In Brazil, Vargas et al. (2018) observed the level of activism through a broad index. Although low, the index grew in 2008, 2010, and 2012, being higher in larger firms presenting worse governance indicators, with a more substantial number of shareholders and

government-controlled companies. The data shows an increase in the number of proposals submitted by shareholders, an increase in the request to adopt multiple voting, and a higher number of news reports on activism in Brazil's leading business newspaper.

The agency theory describes among the agency costs, the principal's monitoring costs. Monitoring reduces the informational asymmetry resulting from the separation of management and ownership (Jensen & Meckling, 1976).

Boards of directors, in theory, help to solve agency problems (Hermalin & Weisbach, 2001). When monitoring the information published in reports to the market, it can reduce the earnings management conducted by managers (Vafeas, 2000).

The literature observes characteristics of the boards such as size, frequency of meetings and the number of independent board members, since independent board members tend to be better supervisors (Anderson, Mansi, & Reeb, 2004). Regarding size, very small or very large boards may find it challenging to make the best decisions. However, the evidence regarding the boards' size is ambiguous in the literature (Hermalin & Weisbach, 2001; Silveira, Barros, & Famá, 2003). Vafeas (1999) showed that the frequency of meetings is inversely related to the value of the company.

Good governance can reduce the need for activist initiatives. Vargas et al. (2018) identified less activism in companies with better governance. Therefore, a negative relationship is expected between the listing in the segment "Novo Mercado" or "Nível 2" in the Brazilian stock exchange B3, and the chances of receiving a request to establish a Fiscal Council (FC).

The firm's size is positively related with the monitoring. Larger firms are more difficult to monitor and may attract the attention of institutional investors that intend to build an image of advocates of the shareholders' interests (Guercio & Hawkins, 1999; Jensen & Meckling, 1976).

Monitoring is also exercised through external governance mechanisms, such as independent audits and market analysts. Studies have related the quality of the audit firm to the quality of the accounting information, the costs of the audit services, and the independence of the auditor. Adams and Neururer (2019) found a negative relationship between the intensity of future activism and the quality of the audit, as measured by the size of the audit firm and by abnormal figures on hiring. In many studies, quality is associated with the big four, the largest audit firms operating worldwide (DeFond, Raghunandan, & Subramanyam, 2002).

Coverage by external analysts reduces informational asymmetry, providing useful information for monitoring produced by external investors. Chang, Dasgupta, and Hilary (2006) show that lower analysts' coverage reduces the likelihood of firms issuing stocks. Yu (2008) shows that the higher the analysts' coverage, the lesser the earnings management. Irani and Oesch (2013) demonstrated that the quality of financial reports dropped after the reduction of analysts' coverage. The authors concluded, with more explicit effects on companies with poorer minority shareholder's protection, that there is a substitution effect between monitoring by market analysts and other governance mechanisms.

Debt holders also monitor the firms. Leverage can have a substitute effect on monitoring since the reduction of available cash has a disciplining effect on management (Jensen, 1986). Souha and Anis (2016) observed a negative relation between leverage and activism.

The revised literature suggests the following research hypothesis regarding the chances of a firm receiving a request to establish a FC, with developments for internal and external monitoring:

H<sub>1</sub>: the frequency of requests to establish a FC is lower in firms with higher quality of external or internal monitoring;

H<sub>1a</sub>: the frequency of requests to establish a FC is lower in firms with higher quality of external monitoring;

H<sub>1b</sub>: the frequency of requests to establish a FC is lower in firms with higher quality of internal monitoring.

Poor performance could draw the attention of shareholders, motivating them to act. The empirical evidence in this sense is ambiguous, which can be attributed to different metrics. Ertimur, Ferri, and Muslu (2011) and Karpoff, Malatesta, and Walkling (1996) identified a negative relation between activism and operational performance. Ertimur et al. (2011) found a negative relation between activism and market performance. Cai and Walkling (2011) observed no relation between operational performance and activism, and Carleton, Nelson, and Weisbach (1998) and Karpoff et al. (1996), did not observe a relation between market performance and activism. In Brazil, Vargas (2013) identified a negative relation between the return on equity and the chances of the company being subject to activism. Guimarães et al. (2018) observed a performance score resulting from the application of data envelopment analysis and concluded that activist shareholders target less efficient firms.

The literature mentions several proxies for firm performance, the usual ones being based on accounting or market indicators. The results are not unanimous regarding the relationship between performance and activism. However, given that the activity of the FC is focused on analyzing and approving reports from auditors and accounting statements, accounting-based metrics may be more suitable to explain the request for establishing such committee. Nevertheless, this research uses accounting and market proxies to analyze the following hypothesis about the relationship between firm performance and the request to establish a FC.

H<sub>2</sub>: the frequency of requests to establish a FC is higher in companies with worse performance

Characteristics of the ownership structure define incentives for shareholder monitoring and agency problems (Jensen & Meckling, 1976). Major shareholders have more significant incentives for monitoring, which would reduce the demand for the FC. On the other hand, they may discourage minority shareholders from intervening (Leal & Carvalhal da Silva, 2006; Shleifer & Vishny, 1986). Therefore, the effect of the concentration of control on the request to establish a FC may be ambiguous.

A group of shareholders can exercise control through the shareholders' agreement (SA). Gorga (2008) and Sternberg, Leal and Bortolon (2011) showed that, in Brazil, these agreements are more frequent in the listing segment of the Brazilian stock exchange B3 '*Novo Mercado*.' Gelman, Castro, and Seidler (2015) found a negative effect of the shareholders' agreement on the firm's value, especially in the presence of clauses linking the vote of the board members to the agreement. Carvalhal (2012) analyzed an index with several characteristics of the SAs and found a positive relation with the firm's value. These studies, therefore, are not enough to establish a clear expected positive or negative relation between the request to establish a FC and the presence of SA.

Empirical evidence shows the role of institutional investors as monitors of management (Gillan & Starks, 2000; Guercio & Hawkins, 1999). These investors' monitoring activity may have a substitute effect on the demand of the shareholders when requesting the establishment of the FC. Smith (1996) identified a relationship between the participation of

institutional investors and activist initiatives. In Brazil, Oliveira, Leal, and Almeida (2012) did not find a significant relation between the participation of pension funds in the firms' ownership structure and the quality of its governance. However, Punsuvo, Kayo, and Barros (2007) identified a negative relation between these two aspects, explaining this result by the high participation of pension funds and the possible alignment of these funds with the firm's controllers. Sonza and Granzotto (2018) found a negative relation between the size of the participation of Brazilian pension funds and the firms' performance. The authors argue that pension funds do not seem to play the role of management monitors well. Thus, it is impossible to predict a positive or negative relation between institutional participation and the request to establish a FC.

The literature suggests a relationship among the ownership structure, monitoring, and agency conflicts. However, the ambiguity of these relations does not allow establishing a clear directional hypothesis. Therefore, the third hypothesis in this study is:

H<sub>3</sub>: The frequency of requests to establish a FC is related to the characteristics of the ownership structure.

**3 METHOD**

The publicly traded firms listed in the Brazilian stock exchange B3 constitute the population of the study. The sample was based on the selection conducted by Vargas et al. (2018), which focused on the firms active in 2008, 2010 and 2012, that met minimum liquidity<sup>ii</sup> of 0.001 in each of these years. These same firms were also observed in 2014 and 2016. The information about the formal requests for the companies to establish a Fiscal Council (FC) was obtained in minutes of the first annual general assembly<sup>iii</sup> of the companies for each year. Permanent FCs were identified in the reference forms and bylaws of the companies, available on the CVM website. Finally, economic-financial data and governance characteristics were obtained in the *Comdineiro* database.

The research analyzes the data for 2010, 2012, 2014, and 2016. The option for the period from 2010 is justified by the improved level of disclosure mandated by the CVM based on Instructions 480 and 481/2009 (CVM, 2009a, 2009b).

Some exclusions were necessary for the following reasons: companies that closed capital or went bankrupt during the years 2014 and 2016; incomplete data on the variables studied; or minutes of meetings without information about the FC. It is important to emphasize that all requests for the establishment of FC were accepted in assembly.

The sample was divided into two groups: firms that received requests to establish a FC and firms without such a committee. Companies that had FCs established in bylaws were not subject to analysis. This strategy highlights the differences between the two groups.

Using the two groups, the quantitative analysis adopted descriptive statistics, correlation analysis, univariate tests (mean and proportional difference tests), and multivariate models (logit).

The basic model of analysis of the factors that influence the chances of the firm to receive a request to establish a FC is described below, where  $p_{it}$  is the probability that  $CF_{it} = 1$ :

$$\ln\left(\frac{p_{it}}{1-p_{it}}\right) = \alpha + \beta_1 Monitoring_{it} + \beta_2 Performance_{it} + \beta_3 Ownership Structure_{it} + \beta_4 Controls_{it} \quad (1)$$

$Monitoring_{it}$ ,  $Performance_{it}$ ,  $Ownership Structure_{it}$  and  $Controls_{it}$  are vectors representing constructs whose proxies are shown in Table 1.

Table 1  
**Description of variables**

<b>Dependent variable</b>			
<b>Variable</b>	<b>Description/Calculation</b>	<b>Expected relation (positive or negative)</b>	<b>References</b>
<i>FC</i>	<i>Dummy</i> = 1 for firms subject to the request for establishing a FC and 0 if there was no request and there is no FC established.		
<b>Internal monitoring</b>			
BS_N	Number of board members	+	Hermalin & Weisbach (2001); Silveira <i>et al.</i> (2003)
IB_PERC	Percentage of independent board members	-	Anderson, Mansi & Reeb (2004)
NM_N	Number of board meetings	+	Vafeas (1999)
AUD	<i>Dummy</i> = 1 if the firm has auditing committee	-	Baioco & Almeida (2017)
GOV	<i>Dummy</i> = 1 if listed in the segment “nível 2” or “Novo Mercado”	-	Vargas <i>et al.</i> (2018)
SIZE	Natural log of total assets	+	Guercio & Hawkins (1999); Jensen & Meckling (1976)
<b>External monitoring</b>			
AN	<i>Dummy</i> = 1 if covered by at least three analysts	-	Chang, Dasgupta, & Hilary (2006); Irani & Oesch (2013); Yu (2008);
BIGFOUR	<i>Dummy</i> = 1 if audited by one of the big four	-	DeFond, Raghunandan, & Subramanyam (2002)
LEVERAGE	Long-term and short-term financing/total assets	-	Jensen (1986); Souha & Anis (2016)
<b>Ownership structure</b>			
SA	<i>Dummy</i> = 1 if there is SA (Shareholders’ Agreement)	+	Gelman, Castro, & Seidler (2015); Strickland, Wiles, & Zenner (1996)
II_PERC	% of shares of institutional investors among the five major shareholders	+	Denis; Mcconnell, (2003); Tan; Keeper, (2008)
MAJOR_ON	% ON shares of the major shareholder	+	La Porta <i>et al.</i> , (2000); Vargas (2013)
<b>Performance</b>			
ROE	Net profit/equity	-	Ertimur, Ferri, & Muslu (2011)
MTB	Market value/equity	-	Ertimur <i>et al.</i> (2011)
<b>Control variables</b>			
SECTOR	<i>Dummies</i> for the nine economic sectors of B3 in the sample (capital goods and services, cyclical consume; non-cyclical consume; financial and others; basic materials; oil, gas, and biofuels; health; information technology; utilities)		
YEAR	<i>Dummies</i> for the years 2010, 2012, 2014, and 2016		

The quality of the monitoring was observed through different proxies for the firms’ internal and external monitoring. Number of board members (BS\_N), percentage of independent board members (IB\_PERC), and number of board meetings (NM\_N) are the variables used to observe the firm’s board. The literature on the effects of the board size is not unanimous concerning positive or negative relationship with monitoring (Hermalin & Weisbach, 2001). Regarding the percentage of independent board members, a negative relation is expected, given the better monitoring exercised by this type of board members (Anderson, Mansi, & Reeb, 2004). Considering that Vafeas (1999) found a negative relation between the number of board meetings and the value of the company, it is expected that

excessive meetings will be detrimental to the monitoring function, increasing the chances of requesting the establishment of FCs.

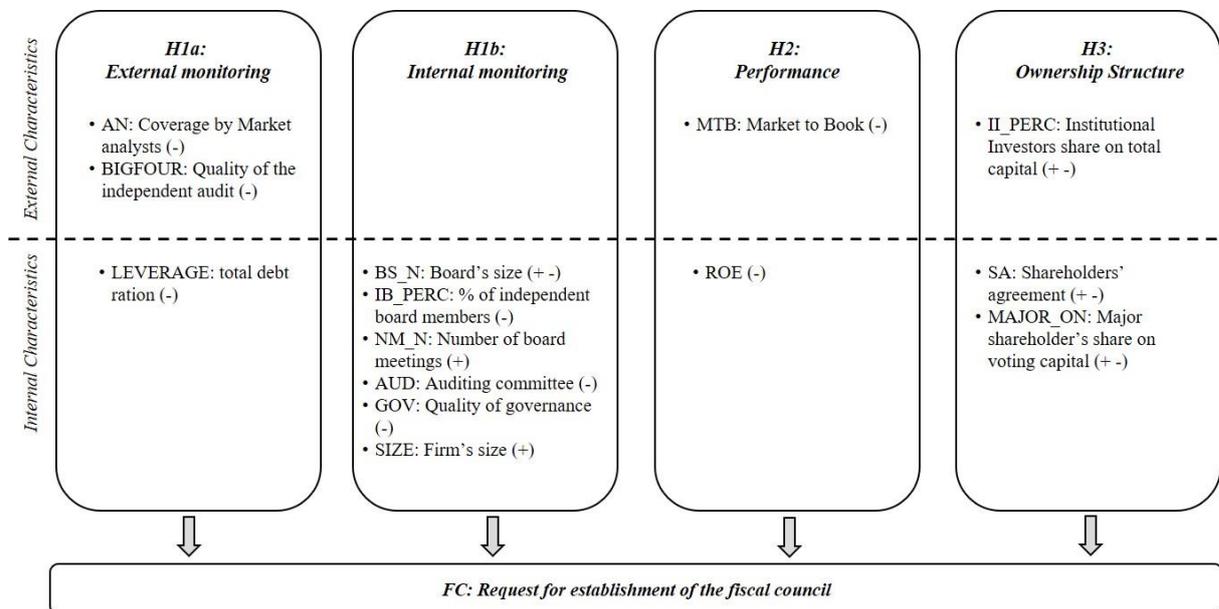
Best governance practices may reduce the requests for the establishment of a FC (Vargas et al., 2018). These practices were observed based on the firm’s listing segments in the Brazilian stock exchange B3 (*Novo Mercado* and *Nível 2*) (GOV). Larger firms (SIZE) demand intensive monitoring, and can positively influence the request to establish a FC.

The Audit Committee (AUD) may represent additional monitoring as a substitute for the FC. Baioco and Almeida (2017) found different impacts of the FC and audit committee when relating them to the quality of the accounting information. External monitoring is characterized by analyst coverage (AN), the presence of the big four audit firms (BIGFOUR) and leverage (LEVERAGE). It is expected that these monitoring characteristics are negatively related to the chances of a firm to receive a request to establish a FC, that is, a substitution effect between the monitoring represented by these variables and the FC is expected.

The ownership structure is characterized by variables that capture the effects of the control concentration, namely, the major shareholder holding common (ON) shares (MAJOR\_ON) and the presence of a shareholders’ agreement (SA). The study also measures the percentage of shares held by institutional investors among the top 5 major shareholders (II\_PERC).

The relationship between performance and activism depends on the metrics of activism and performance observed. This research examined accounting (ROE) and market (MTB) metrics, expecting a negative relationship of these metrics with the request to establish a FC.

Figure 1 presents the analytical model of the research, with the hypotheses, variables, and expected relation in the investigation of the effects on the request to establish a FC.



**Figure 1:** Research’s analytical model

**4 RESULTS**

The sample was composed by firms that received a request to establish a Fiscal Council and firms that do not have one, which resulted in a total of 88 firms and 341 observations (firms-year)<sup>iv</sup>.

Table 2 shows that more than half of the firms-year was requested to establish a FC (54.8%). As for internal monitoring, the boards are formed, on average, by seven members. The company *Electro Aço Altona*, in 2014, had the largest board, whereas the smaller one was observed in the company *Fertilizantes Heringer*, in 2010. The average percentage of independent board members in the sample was 27.5%. However, 87 firms-year showed 0% of independent board members. The average number of board meetings is 11 per year, with the maximum observed in the company *CCR* in 2016. About 33% of the observations presented an audit committee.

The big four audit firms operate in almost 90% of the firms-year. Coverage by at least three market analysts is less frequent, occurring in 48.7% of the observations.

The ownership structure presents the usual concentration of control observed in Brazilian studies. The major shareholder has, on average, 53% of ON shares. Shareholders' agreements are present in 10% of the observations. Institutional investors are present in approximately 55% of the observations, and the average participation in the entire sample is 6.7%.

The performance, both regarding the accounting (ROE) and the market (MTB) metrics, showed positive mean values. High standard deviations suggest the need of treatment for extreme observations.

Approximately 80% of the sample is listed in the segments “*Novo Mercado*” or “*Nível 2*” of the Brazilian stock exchange B3. The average total debt is around 30% of total assets.

Table 2  
**Descriptive statistic**

	#Obs.	Mean	Standard deviation	Minimum	Maximum
FC	341	0.548		0	1
<b>Internal monitoring</b>					
BS_N	341	7.278	2.395	1	20
IB_PERC	341	0.275	0.222	0	1
NM_N	341	11.123	6.879	1	51
AUD	341	0.328		0	1
<b>External monitoring</b>					
AN	341	0.487		0	1
BIGFOUR	341	0.886		0	1
<b>Ownership structure</b>					
SA	341	0.100		0	1
II_PERC	341	6.755	10.819	0	75.25
MAJOR_ON	341	52.973	20.412	0	100
<b>Performance</b>					
ROE	341	9.690	47.381	-332.2	577.005
MTB	341	1.739	3.129	-25.444	19.594
<b>Control variables</b>					
SIZE	341	1.370	1.588	-3.293	7.210
LEVERAGE	341	0.310	0.184	0	0.892
GOV	341	0.792		0	1

The observed correlations between the metric variables are not high. The greatest correlation occurs between the size of the company (SIZE) and the board's size (BS\_N). Correlations are also positive and statistically significant between the firm's size and the number of board meetings, participation of institutional investors, and control concentration.

The performance measures adopted in the research presented a negative correlation. The percentage of ON shares held by major shareholders is negatively related to the participation of institutional investors.

The sample suggests that larger boards, with a higher proportion of independent board members, have a positive correlation with the number of annual meetings. Institutional participation also correlates positively with the number of meetings.

**Table 3**  
**Correlations**

	BS_N	IB_PER C	NM_N	II_PERC	MAJOR_ON	ROE	MTB	SIZE	LEVERAG E
BS_N	1								
IB_PERC	0.007	1							
NM_N	0.154*	0.123*	1						
II_PERC	0.093	0.080	0.166*	1					
MAJOR_ON	0.109*	0.031	0.173*	-0.118*	1				
ROE	-0.017	-0.129*	-0.058	-0.025	-0.004	1			
MTB	0.116*	0.013	0.106	-0.022	-0.053	0.311*	1		
SIZE	0.456*	0.067	0.251*	0.107*	0.128*	-0.063	0.068	1	
LEVERAGE	0.019	0.021	0.139*	0.104	-0.151*	-0.064	0.158*	-0.065	1

Note: \* indicate statistical significance at 5%

Table 4 shows the results of the univariate tests comparing the firms that were requested to establish a FC (FC = 1) and those that do not have a FC established (FC=0).

Among the characteristics regarding internal monitoring, the research identified two that presented differences with statistical significance. The percentage of independent board members (IB\_PERC) is lower in firms that received requests to establish a FC. The difference is even more significant when observed the presence of audit committees (AUD). About 24% of the firms receiving requests presented auditing committees, while the percentage for the other companies was almost 44%.

Regarding external monitoring, the predominance of the big four audit firms in the two groups possibly reduces the chances to differentiate them. However, coverage by at least three market analysts is less frequent among the firms requested to establish a FC (43%) than in those without a request (55%).

None of the characteristics related to the ownership structure presented differences with statistical significance. The two groups have a high percentage of ON shares held by a major shareholder (MAJOR\_ON), similar participation of institutional investors (II\_PERC) and a low presence of shareholders' agreements (SA).

The two performance variables (ROE and MTB) presented significant differences, with smaller means in the group of firms that received requests to establish a FC.

No differences were observed in the variables SIZE, leverage (LEVERAGE), or listing in differentiated segments of corporate governance of B3 (GOV).

Univariate analyses suggest that the characteristics of internal monitoring (percentage of independent and audit committee), external monitoring (coverage by analysts), and performance (ROE and MTB) may be used to discriminate between the two groups of firms. The characteristics of the ownership structure that were observed, however, do not seem to be different between the two groups.

Table 4  
**Tests of differences in means and proportions**

<i>Quantitative variables</i>						
	FC=0		FC=1		Difference	
	#	Mean	#	Mean	(0-1)	Stat. T
IB_PERC	147	0.307	182	0.253	0.053	2.179**
BS_N	147	7	182	7.5	-0.500	-1.897
NM_N	147	10.844	182	11.390	-0.547	-0.708
II_PERC	147	6.371	182	7.262	-0.892	-0.741
MAJOR_ON	147	54.256	182	51.877	2.379	1.054
ROE	147	10.106	182	2.260	4.846	2.162**
MTB	147	1.785	182	1.391	0.394	2.103**
SIZE	147	1.370	182	1.366	0.004	0.020
LEVERAGE	147	0.282	182	0.323	-0.040	-2.012
<i>Qualitative variables</i>						
	FC=0		FC=1		Difference	
	#	%	#	%		Stat. z
AUD	147	0.435	182	0.242	0.194	3.718***
AN	147	0.551	182	0.434	0.117	2.110**
BIGFOUR	147	0.871	182	0.896	-0.025	-0.701
SA	147	0.048	182	0.137	-0.090	-2.731
GOV	147	0.803	182	0.791	0.012	0.258

Notes: (i) the sample was treated for the presence of outliers in variables ROE and MTB, that resulted in exclusion of 12 observations; (ii) the asterisks indicate statistical significance at (\*)10%, (\*\*)5% and (\*\*\*)1%.

The logit models were then estimated. The low correlations found before did not suggest problems of multicollinearity. As confirmation, analyses of the variance inflation factor (VIF) were made for each model, estimating it as a linear probability model, presenting values lower than 2.5. The possible presence of autocorrelation of errors was addressed using clustered errors by the firm, for all models. The research addressed endogeneity problems due to omitted variables by using specific control variables.

It is important to observe that the estimation of fixed effects models for panel data was not feasible, given the number of companies in the sample in which the dependent variable (FC) did not change in the observed years.

Table 5 shows the results. The proxies of each construct were analyzed together, and the results presented in the models 1 to 4. Finally, the model 6 presents the complete model with all the variables.

In contrast to the suggestions based on the univariate analysis, there is no statistically significant association between proxies for external monitoring and the probability of requesting the establishment of a FC. As for internal monitoring, the audit committee has a negative relationship with the chances of requesting the establishment of a FC, confirming the results of the test of difference of proportions. Although the estimated coefficient for the percentage of independent board members is negative, it is not statistically significant at the conventional levels. However, the board's size, which did not present differences in the univariate tests, is positively associated with the chances of a request to establish a FC, suggesting that large boards may exercise less efficient monitoring.

The coefficients of the internal monitoring proxies are compatible with H<sub>1b</sub>, which states that the higher the quality of internal monitoring, the lower the chances of activism. However, the estimated coefficients for the external monitoring proxies are not significant at the conventional levels, and therefore, H<sub>1a</sub> was not supported.

The higher the firm's ROE, the lower is the chance of receiving a request to establish a FC. This effect is only observed for the ROE variable. The relationship is also negative when

using Market-to-Book as a proxy for performance, however, the estimated coefficient loses statistical significance in this case. Thus, there are partial evidences favorable to H<sub>2</sub>.

The variables regarding ownership structure, which did not differentiate the groups in the univariate tests, presented a positive and statistically significant relation with the presence of shareholders' agreements (SA). This observation is evidence favorable to H<sub>3</sub>.

**Table 5**  
**Logit models**

VARIABLES	External. monitoring (1)	Internal monitoring (2)	Ownership structure (3)	Performance (4)	Complete (6)
NA	-0.696 (0.423)				-0.562 (0.479)
BIGFOUR	0.669 (0.585)				0.892 (0.565)
LEVERAGE	1.386 (1.039)				1.049 (1.055)
BS_N		0.130 (0.083)			0.175* (0.091)
IB_PERC		-1.430 (0.919)			-1.444 (0.918)
NM_N		0.004 (0.024)			0.012 (0.028)
AUD		-0.935** (0.466)			-0.906* (0.465)
GOV		-0.049 (0.575)			-0.143 (0.609)
SIZE		0.234 (0.172)			0.195 (0.164)
SA			1.124** (0.466)		1.037** (0.463)
II_PERC			-0.003 (0.019)		-0.007 (0.020)
MAJOR_ON			-0.006 (0.009)		-0.008 (0.009)
ROE				-0.012 (0.009)	-0.014* (0.008)
MTB				-0.104 (0.114)	-0.160 (0.109)
Constant	-0.046 (0.725)	0.310 (0.864)	0.948 (0.741)	1.152** (0.566)	-0.007 (1.125)
Dummy year and sector	Yes	Yes	Yes	Yes	Yes
#Obs.	317	317	317	317	317
LR Chi2	15.27	22.29	18.70	16.19	40.00
Prob>Chi2	0.227	0.100	0.096	0.134	0.015
Pseudo R2	0.050	0.086	0.047	0.041	0.141

Note: \*, \*\*, and \*\*\* indicate statistical significance, respectively, at 10%, 5% and 1%.

## 5 DISCUSSION

Regarding  $H_{1b}$ , the research found evidence favorable to the influence of the audit committee (AUD) and the board's size, both proxies for internal monitoring. The variables related to characteristics of external monitoring are not significantly associated with the request to establish a fiscal council (FC).

Baioco and Almeida (2017) discuss the differences between the FC and the audit committee and find different effects regarding the quality of accounting information. Carcello, Hermanson, Neal, and Riley (2002) emphasize the importance of the audit committee in protecting independent auditors from the managers' pressure. The negative relation for the audit committee in this research is consistent with the substitution effect between the two entities.

Among the characteristics of the firms' boards, only the percentage of independent board members was different between the two groups analyzed. In logit models, however, only the boards' size presented statistical significance. Larger boards favor the request to establish a FC. This evidence is consistent with the literature that suggests that very small or very large boards may find it challenging to make decisions (Hermalin & Weisbach, 2001; Silveira et al., 2003).

The listing in the two most demanding segments of the Brazilian stock exchange B3 and the firm's size are unrelated to the request to establish a FC. The two groups were homogeneous in these aspects, as observed in the tests of difference of means and proportions, which may have impaired the analysis in logit models.

The expertise and reputation of the audit firm has its price. Lin and Liu (2009) relate the choice of a large audit firm to the trade-off between maintaining control privileges and improving transparency with a consequent reduction in the cost of capital. Hiring one of the big four could indicate to minority shareholders a better quality in monitoring, reducing the need to request the establishment of a FC. The results, however, did not confirm the expectation. In addition, the presence of the big four in almost 90% of the sample may have impaired the analysis.

Market analysts are information intermediaries. Coverage by analysts can reduce earnings management and facilitate access to capital (Chang et al., 2006; Yu, 2008). In Brazil, Almeida and Rodrigues (2016) find a positive association between coverage by analysts and voluntary disclosure during the adoption of IFRS. However, the expectation of the negative relationship between this metric and the request to establish FC was not confirmed, although the proportion of firms covered by at least three analysts was different between the two groups (43% in the firms that received requests and 55 % in the others).

Souha and Anis (2016) find a negative relation between leverage and activism. The results of this study, however, do not confirm the substitution effect suggested in the literature.

Control concentration and the participation of institutional investors do not differentiate the groups. The presence of shareholders' agreements, however, is higher in the firms that receive requests to establish a FC (14%) than in the other companies (5%). This variable is positively associated with the request for a FC. In Brazil, these agreements allow, for example, the binding of board members' votes. Gelman et al. (2015) found a negative effect of this type of clause on the firm's value, which suggests an "entrenchment effect" of the shareholders. Carvalho (2012) analyzed a broader set of clauses and found a positive relation with the value and degree of investors' protection.

Low performance is pointed out in the literature as a motivator of activism. The two observed variables, based on accounting and market value metrics, presented lower average

values in the group of companies that received requests to establish a FC. In the multivariate analysis, however, only ROE showed the expected negative relation. Although the functions of the FC are more related to management oversight than to activities of the administration, the request to establish a FC may indicate dissatisfaction with the firms' results. The request is one of the ways the legislation offers to minority shareholders to increase monitoring, and the FC is a body of the governance where these shareholders have a guaranteed seat.

It is important to emphasize that the criteria adopted for the selection of the sample, which make it possible to obtain more information per company, may have impaired the diversity of the sample. In the restricted Brazilian market, this is a usual trade-off. The strong presence of firms listed in the segments "Novo Mercado" and "Nível 2" of the B3 in the two groups (about 80%) most likely homogenized the characteristics of the boards.

## 6 CONCLUSION

This article analyzed the request to establish a fiscal council (FC)<sup>v</sup> in a firm, considering this act an expression of shareholders' activism, which the literature treats as a response of shareholders to agency conflicts (Gillan & Starks, 2007). In capital-concentrated markets such as in Brazil, the conflicts emerge, especially between controllers and minority shareholders.

FCs, according to legal determination, supervise the acts of the managers. The quality of the monitoring exercised by the structures within and outside the firm, as well as the monitoring incentives determined by its ownership structure, may lead minority shareholders to refrain from requiring the establishment of the committee. This research analyzed the possible relationship of substitution between the monitoring and the ownership structure, and the request to establish the FC. Performance is added to the variables of interest as a motivator of the shareholders' activist initiative, who try to convey their dissatisfaction.

The sample consisted of 88 firms observed in the years 2010, 2012, 2014 and 2016. The sample was composed by firms that received requests to establish a FC and firms that did not have one.

The comparison between the two groups of companies showed that those who received a request to establish a FC have a lower proportion of independent board members and worse performance, on average. This group also presented a smaller proportion of companies with audit committee and a smaller proportion of companies covered by at least three market analysts. The variables related to the ownership structure did not present statistically significant differences between the groups.

The variables that influence the chances in favor of the request to establish a FC were analyzed using logit models. The results on the variables referring to the quality of internal monitoring are compatible with H1, which does not occur with variables of external monitoring. The presence of the audit committee has a negative relation with the odds in favor of the request to establish a FC, whereas the board's size has a positive relationship.

The negative relationship between the ROE and the request to establish a FC is compatible with H2. As for H3 and the relationship between the ownership structure and activism, only the presence of the shareholders' agreement suggests a positive relation with the chances of the request. Institutional investors and control concentration were not related to the request.

Results suggest that the FC may partially substitute other governance mechanisms, such as the audit committee. Therefore, the research contributes to the debate on the interaction among the different governance mechanisms, particularly regarding the potential

effects of complementarity and substitutability. In addition, the evidence that requests the establishment of the FCs are more frequent in companies whose performance is poorer, is in line with the revised empirical literature and contributes to the debate about what motivates shareholders to be more or less passive, suggesting that past financial performance may be a key element in understanding this phenomenon, even in environments with concentrated control (Leal & Carvalhal da Silva, 2006; Shleifer & Vishny, 1986).

As a managerial contribution, this research may help to understand a phenomenon in the Brazilian market that became especially relevant after the changes introduced by the instruction CVM 561/2015 and the distance voting (CVM, 2015). The bulletins submitted to the shareholders for voting necessarily present the option of requesting the installation of the FC, which facilitates the manifestation and achievement of the objective. In 2018, when all companies were forced to adopt the distance voting, some companies were taken by surprise with the result of the ballot. The election of the members for the FC was made only by the shareholders present at the meeting without the participation of the distance voters. Therefore, the process facilitates obtaining the necessary votes for the installation of the FC. However, the distance voting bulletin does not allow suggesting names to compose the committee (Gutierrez, 2018; Selmi, 2018). Thus, when understanding the factors that may be related to the request to establish a FC, the companies may anticipate themselves to the event.

The new scenario also allows new investigations, based on the observation of the voting documents, which may have altered the frequency of requests and its relation with the constructs investigated in this research.

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<sup>i</sup> Law 6404 of December 15, 1976 (Brazilian Corporation Law), Art. 161 §2 establishes that such a request may be made by shareholders representing at least 10% of the voting shares or 5% of the shares without voting rights.

<sup>ii</sup>  $Liquidity = 100 \frac{P}{P} \sqrt{\frac{n}{N} \times \frac{V}{V}}$ , where P = number of trading days and p = number of days the stock was traded; N = number of trades on the stock exchange in the period, and n = number of trades with the stock; and V = the amount traded on the stock exchange in the observed period and v = the amount traded with the share.

<sup>iii</sup> The Brazilian Corporation Law establishes in Article 132 that a general assembly shall occur in the first four months following the end of the fiscal year. Among the deliberations is the election of members of the fiscal council, when appropriate.

<sup>iv</sup> The total number of firms per year is less than 352 (88 x 4) because of the cases where the FC was permanent: (i) *Banco Panamericano* and *Marfrig*, within 3 years of requesting the establishment of the FC; (ii) *Comgás* and *Itaú Unibanco Holding* in two years; and (iii) *Bradesco* in one year.

<sup>v</sup> The minutes of the meetings, for the most part, do not identify the shareholders who have requested the establishment of the fiscal council. Therefore, the requests do not necessarily come from minority shareholders. The observation of the minutes of 2016, however, shows that, in the minutes where it is possible to identify the origin of the request, more than 2/3 of the solicitations came from minority shareholders.

*Ativismo e Solicitação de Instalação do Conselho Fiscal: influência do Monitoramento, Desempenho e Estrutura de Propriedade*

## RESUMO

**Objetivo:** Este artigo investiga se as características do monitoramento, da estrutura de propriedade e do desempenho se associam às chances de solicitação de instalação do Conselho Fiscal (CF). A solicitação pode ser entendida como uma manifestação de ativismo, uma vez que sinaliza a disposição dos acionistas em aumentar a fiscalização sobre a gestão.

**Método:** Empresas que foram alvo de solicitação e empresas que não têm o CF instalado foram observadas entre 2010 e 2016. Os dois grupos foram comparados e modelos logit empregados para análise das variáveis relacionadas com as chances a favor do evento.

**Originalidade/relevância:** a pesquisa contribui para a ainda limitada literatura sobre ativismo no Brasil e investiga de forma pioneira um órgão de governança incomum no cenário internacional.

**Resultados:** O tamanho do conselho associa-se positivamente ao evento e a presença do comitê de auditoria negativamente. O desempenho tem relação negativa com as chances de solicitação, em linha com evidências na literatura. A probabilidade de solicitação é maior em empresas com acordos de acionistas, o que sugere o reconhecimento de forma negativa pelos acionistas dessa ferramenta de articulação do controle.

**Contribuições Teóricas/metodológicas:** Os resultados contribuem para os debates acadêmicos relativos aos efeitos de complementação versus substituição de diferentes mecanismos de governança e aos motivadores do ativismo dos acionistas.

**Contribuições sociais/para a gestão:** Os achados podem auxiliar as empresas a se anteciparem a esse tipo de demanda, facilitada após a implantação do voto a distância.

**Palavras-chave:** *ativismo; conselho fiscal; comitê de auditoria; acordos de acionistas; acionistas minoritários.*

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Patricia Maria Bortolon 

Universidade Federal do Espírito Santo (UFES),  
Espírito Santo, Brasil  
E-mail: patricia.bortolon@ufes.br

Layziane Souza Silva 

Universidade Federal do Espírito Santo (UFES),  
Espírito Santo, Brasil  
E-mail: layzianesilva@gmail.com

Lucas Ayres Barreira de Campos  
Barros 

Universidade de São Paulo (USP), São Paulo,  
Brasil  
E-mail: lucasbarros@usp.br

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