

Financing Acquisitions and Growth: The Ambev Case

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ABSTRACT

This case study aimed to investigate the growth driven by M&As of Ambev in the period between 1999 and 2015, emphasizing two sources of financing addressed in Jensen (1986). On the one hand, the Free Cash Flow Theory postulates that managers would apply resources generated by self-financing in acquisitions. On the other hand, companies could incur on debts to perform the so-called leveraged buyouts. To verify if any of these theoretical constructions is consistent with the Ambev case, were analyzed the free cash flows and the company's indebtedness. The results show that each of these theories bears similarities to a specific period of growth of the company. At first, this growth refers to leveraged buyouts. After 2008, the strong reduction of indebtedness and increased self-financing refer to the Free Cash Flow Theory. These results unveil a model of growth that can be adopted strategically by other companies.

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1 Introduction

The Companhia de Bebidas das Américas (Ambev) is a multinational beverage company headquartered in Brazil, currently participating in the largest conglomerate of this industry in the world, Anheuser-Busch InBev. By 2015, Ambev ranked among the companies which had the highest market value in Brazil and Latin America. Before reaching this prominence position, Ambev's history was characterized by many mergers and acquisitions (hereafter, M&As), starting with its origin in 1998, from the merger of Brahma brewery with Antarctica company.

The literature on M&As presents several reasons that justify them (Camargos & Barbosa, 2003, Camargos & Coutinho, 2008, Kloeckner, 1994). As for Ambev, M&As were mainly implemented to penetrate markets in countries where the company was not yet active (Santos,

2012). But which resources financed this growth through M&As? In general, self-financing resources are used for such purposes, as well as debt, and exchange of shares may also occur (Damodaran, 2001; Gugler, Mueller, Weishchelbaumer & Yortoglu, 2012; Jensen, 1986).

Although it is possible to use combinations of these financial resources, payments with those originated from self-financing or from debt are recurrent in acquisitions, while stock exchanges usually occur in mergers. However, mergers are not very regular, both in the set of M&As in Brazil (Camargos & Barbosa, 2003) and in the history of transactions carried out by Ambev. As a result, this case study focuses primarily into analyzing the company's self-financing and indebtedness.

Two theoretical constructs disseminated in a seminal paper by Jensen (1986) provide a basis

for acquisitions that use these two sources of funds as a form of financing. On the one hand, the Free Cash Flow Theory advocates that the manager would pursue the company's growth for behavioral reasons, using the resources generated by self-financing to make acquisitions. On the other hand, the theoretical construction addressing the so-called leveraged buyouts proposes that companies could incur debts to make acquisitions.

Given this theoretical framework, this case study aimed to investigate the growth driven by M&As of Ambev in the period between 1999 and 2015, emphasizing two sources of financing as addressed in Jensen (1986). To fulfill this purpose, it was analyzed the free cash flows and indebtedness based on Ambev's financial data.

The importance of this study is its pioneering approach to M&As oriented growth financing in Brazil. No other studies on this topic were published in Brazilian scientific journals. In addition, data from one of the largest Brazilian companies in terms of market value are analyzed, which shows a growth strategy that can be adopted by other companies.

After this introduction, Section 2 discusses Agency Theory, Free Cash Flow Theory and leveraged buyouts. Section 3 addresses the methodology, describing the data origin and which analyzes were used to verify if any of the theoretical construction is consistent with the Ambev case. Section 4 presents, in fact, the financial analysis of the company, empirically verifying if the information refers to the theoretical constructions. Finally, Section 5 contains the final considerations.

2 Theoretical Framework

2.1 The Agency Theory

With the separation between ownership and management in publicly traded companies, the figure of the professional manager appeared. Such agent would be hired to lead the company so as to maximize financial performance and hence shareholders' wealth (Berle & Means, 1932). This relationship would be governed by contracts that would regulate the manager's acting, while also granting him certain authority to make decisions. However, if both parties were utility-maximizing, there would be reasons to believe that the manager

would not act according to the shareholders' interests (Jensen & Meckling, 1976).

The Agency Theory, formalized by Jensen and Meckling (1976) for the context of this relationship, brought to light the existence of asymmetries of information and conflicts of interests between managers and shareholders. The asymmetry of information can be illustrated by the fact that managers are well aware of confidential internal resources, which are strategic to the company, whereas the shareholders do not know much beyond what is published in financial reports (Tirole, 2006). Conflicts of interest are manifested when the manager, despite being hired to act in order to maximize shareholder wealth, would put his private interests as a priority (Jensen & Meckling, 1976). These conflicts would be more intense in companies whose ownership of capital is widely dispersed, while decision-making power is highly concentrated in managers (Tirole, 2006).

2.2 The Free Cash Flow Theory

The Free Cash Flow Theory refers to a specific circumstance in which the conflict of interests between managers and shareholders occurs: the payment of dividends. Distributing dividends to shareholders reduces the financial resources controlled by the manager (Jensen, 1986). On the other hand, a manager wishes to control more resources to fulfill his interest in seeking the growth of the company, since this would imply an increase in his prestige and compensation (Easterbrook 1984, Marris 1963 and Murphy 1985).

Thus, acquisitions would be one way for managers to use these resources with the purpose of making the company grow rather than distributing them to shareholders (Camargos & Barbosa, 2003; Jensen, 1986). Such growth is also a way for managers to prevent the companies they manage from becoming the target of hostile takeovers, which would jeopardize their positions. (Fama 1980; Tirole, 2001, 2006).

Free cash flows are the surplus of resources resulting from the company's operating activities, that is, the self-financing. These cash flows tend to be a considerable amount in companies in economic sectors where competitive pressure is not strong enough to reduce extraordinary profits (Jensen, 1986); or even in companies that have

more than the necessary capital to finance all the new available projects that have positive net present value after discounting the cost of capital (Camargos & Barbosa, 2003; Jensen, 1986).

The Free Cash Flow Theory postulates that, although shareholders claim that this capital be distributed in the form of dividends, it would be used by managers to promote company growth through acquisitions (Jensen, 1986). Considering that there are several reasons that justify acquisitions (Camargos & Barbosa, 2003; Camargo & Coutinho, 2008; Kloeckner, 1994), in order for the acquiring companies to be included in this theory, they should perform very favorably regarding the free cash flows generation before these operations. In addition, such capital could be used even in the acquisitions of underperforming targets (Jensen, 1986). This seems reasonable when the decision-making in relation to the transactions comes from the manager's particular interests, disregarding the creation or not of wealth for the shareholder.

Graham, Harvey, and Rajgopal (2006) conducted a survey that strongly corroborates this behavioral motivation. These authors applied a survey to about 400 financial managers of large US companies and concluded that it is very recurrent to consider the manager's personal interests in corporate decisions, even causing the destruction of shareholder value. Silva, Kayo and Nardi (2016) showed that, in the scope of Brazilian publicly traded companies, acquisitions performed by companies ranked in the lowest levels of governance, in which there is a greater concentration of decision-making power in managers, tend to be inefficient.

2.3 Leveraged Buyouts

Another form of acquisition financing occurs in so-called leveraged buyouts. In these operations, the acquiring company uses debt to raise up most of the resources used to purchase the target company, which usually becomes a privately held company after the transaction is completed (Damodaran, 2006).

Performing a leveraged buyout depends on the approval of the creditor institution, which would observe the level of indebtedness of the acquiring company and, based on this, would stipulate bankruptcy costs. However, these costs are reduced when companies have low values in

free cash flows and excellent investment opportunities, which would justify contracting the debt (Jensen, 1986; Tirole, 2001).

According to Jensen's (1986), the targets of leveraged buyouts would be companies that historically presented high volumes of free cash flows. For this author, the surplus cash flows, from the target company, would be used to pay the debt contracted to carry out the transaction until a capital structure, which would be permanent, was reached (Jensen, 1986). In this sense, this approach has a transactional character (Cohn, Mills & Towery, 2014).

More recent studies contrast with Jensen's (1986) theory. Cohn, Mills & Towery (2014) analyzed leveraged buyouts in the United States over the past two decades and found strong persistence of debts contracted by acquiring firms. Axelson, Jenkinson, Stromberg & Weisbach (2013) conclude that the cost and availability of credit have a greater influence on leveraged buyouts than levels of indebtedness or the generation of free cash flows.

Table 1 lists some important aspects for the differentiation between the two theoretical constructions addressed in this study.

Table 1. Free Cash Flow Theory and Leveraged Buyouts

	Free Cash Flow Theory	Leveraged Buyout
M&As Financing	Internally generated resources, self-financing.	Most of the funds come from debts.
Performance of the acquiring company	Ensures surplus resources to finance acquisitions.	Not sufficient to finance acquisitions.
Performance of the Target Company	It may even be unsatisfactory.	Satisfactory, with large volume of free cash flows.

Source: Own elaboration.

3 Methodology

This research is characterized as a case study of a descriptive nature, as it investigates the growth driven by M&As of a single company, Ambev. It is also characterized as exploratory, due to the fact that it follows an approach little explored in the scope of M&As studies in Brazil: analyzing the funding sources used by firms in conducting their M&A oriented growth strategy.

In this study, the texts used for the

elaboration of the theoretical framework, Section 2, were accessed through databases that congregate publications in journals, when they were articles, and through print, in some book searches. For the preparation of Section 4, which deals with the growth trajectory driven by M&As of Ambev, the information on the Investor Relations website was used, including reports on specific events involving the company. This section was also supplemented with information from other studies quoting Ambev's M&As.

The data used to perform the financial analysis shown in Section 5 are from the Comdinheiro® [sic] database and were adjusted by the Extended Consumer Price Index (IPCA). To calculate the free cash flows from operations, seen as an indicator of self-financing, and to evaluate the indebtedness, the data of Ambev's financial statements were collected. The free cash flows from transactions were calculated according to the formula proposed by Fleuriet and Zeidan (2015), which is shown below:

$$\text{FCL} = \text{LOP} (1 - \% \text{IR}) - \Delta \text{NCG} - \Delta \text{AI} \quad (4)$$

In the formula, the Free Cash Flow (FCL) results from the operating profit (LOP) deducted from the percentage referring to Income Tax (IR) and subtracted from the variations in Working Capital Requirement (NCG) and fixed assets (AI).

The verification of the existence of congruence between the growth of Ambev and the theoretical constructions regarding the financing of M&As was verified through the data referring to the indebtedness and the self-financing of that company. Both the gross debt and the free cash flows of the operations were analyzed, as well as two indexes in which these variables were divided by total assets. Such indexes were necessary to protect the proportion of the variables in relation to the size of the company, since it follows a growth trajectory, which could imply some distortions.

4 Growth through mergers and acquisitions of Ambev

The Companhia de Bebidas das Américas (Ambev) was created by the merger of Companhia Cervejeira Brahma (Brahma) with Companhia Antarctica Paulista Indústria Brasileira de Bebidas e Conexos (Antarctica) in September 1998, and

the process took place throughout 1999 and 2000 (Ambev, 2015). This transaction was performed by the two competing companies in order to increase competitiveness, gain scale and internationalize (Camargos & Barbosa, 2015). The operation resulted in the establishment of a leading company in the Brazilian beer market and also with a strong presence in the nonalcoholic beverages market (Ambev, 2015).

Ambev's international expansion comes from Brahma's operations, which was already commercializing its beverages in countries such as Argentina, Paraguay and Venezuela. After the creation of Ambev, its internationalization was accelerated through partnerships and, mainly, acquisitions. In 2003, it undertook a transaction with the Quinsa Brewery, and from this point it has led the beverage markets in countries such as Argentina, Bolivia, Paraguay and Uruguay (Ambev, 2015). Until that year, the company had increased its leverage as a way of financing its internationalization (Camargos & Barbosa, 2005).

Since then, Ambev has performed several acquisitions of companies in Central America, Peru, Ecuador, and Dominican Republic, participating in the control of companies in Canada and establishing an important marketing agreement in the Caribbean. In 2015, the company was operating in the following countries: Brazil, Canada, Argentina, Bolivia, Chile, Paraguay, Uruguay, Colombia, Guatemala, Dominican Republic, Cuba, Ecuador, Peru, El Salvador, Nicaragua, Saint Vincent, Dominica and Antigua (Ambev, 2015).

The main reason that led Ambev to internationalization, a process seen here as a growth driven by M&As, was to have access to markets. Nevertheless, decisions on access to strategic resources and the acquisition of competences by the company also impacted the decisions. Rights in the production of trademarks were one of these strategic resources of great relevance to Ambev. In order to evaluate the M&As, the company considered access to markets through the continuity of production, commercialization and distribution of the products already present in the countries, as well as the possibility of introducing products of its portfolio that would be new products in these countries (Santos, 2012).

Table 2 illustrates several transactions in which Ambev became involved during its growth

driven by M&As. It describes the transactions involving Ambev itself or, in less recurring cases, acquisitions made by other companies of the group, over which Ambev has control. It should be noted that the process of an acquisition may take more than a year to be completed.

Table 2. Ambev's Mergers and Acquisitions

Year	M&A Transactions
1999	<ul style="list-style-type: none"> Ambev originates from the merger of Companhia Brahma (Brahma) with Companhia Antarctica Paulista (Antarctica).
2000	<ul style="list-style-type: none"> Formation of a joint venture with Grupo Danone in Uruguay; Acquisition of Salus Sociedad Anónima, from Uruguay.
2001	<ul style="list-style-type: none"> Acquisition of Cerveceria Internacional S.A., from Paraguay; Acquisition of Cerveceria y Malteria Paysandu S.A. (Cympay), from Uruguay.
2002	<ul style="list-style-type: none"> Formation of the joint venture with Central America Bottling Corporation (CabCorp), in Guatemala; Purchase of a 36% stake in Quilmes Industrial S.A. (Quinsa), headquartered in Argentina.
2003	<ul style="list-style-type: none"> Acquisition of Cerveceria Suramericana (Cervesursa), from Ecuador; Acquisition of Embotelladora Rivera, from Peru.
2004	<ul style="list-style-type: none"> Merger with Belgian Interbrew, creating the giant Imbev.
2007	<ul style="list-style-type: none"> Acquisition of the Lakeport Brewing Income Fund in Canada through the subsidiary Labatt.
2008	<ul style="list-style-type: none"> Ambev completes the acquisition of Quilmes Industrial S.A. (Quinsa) after gradually increasing its participation in the company; Inbev buys American Anheuser-Busch and creates Anheuser-Busch InBev (AB Imbev), the largest brewer in the world.
2010	<ul style="list-style-type: none"> Purchase of 15% of Cerveceria Regional S.A., from Venezuela.
2012	<ul style="list-style-type: none"> Acquisition of Careceria Nacional Dominicana S.A. (CDN), from Dominican Republic; AB InBev completes acquisition of Grupo Modelo (Corona), from Mexico, with purchase of half that it did not yet own.
2014	<ul style="list-style-type: none"> Establishment of joint venture with Bucanero, leader in the beer sector in Cuba.

2015	<ul style="list-style-type: none"> Acquisition of the Colorado brewery in Brazil; Takeover of Banks Holdings Company, which controls the beverage manufacturer and distributor Banks Holdings Company (BHL) of Barbados; Acquisition of Bogotá Beer Company (BBC) in Colombia.
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Source: Own elaboration with information from Santos (2012), as well as those from Ambev's Investor Relations website and the reports disclosed therein.

Table 3 shows Ambev's growth in terms of total assets and market value.

Table 3. Ambev's Total Assets and Market Value

Date	2000	2005	2010	2015	Growth 2000-2015
Total Assets	23.2	59.6	60.4	90.2	289%
Market Value	49.3	96.2	205.9	270.5	449%

Note. Amounts in billions of R\$, adjusted by the IPCA.
Source: Own elaboration with Comdinheiro data.

In this table, the year 2000 corresponds to the end of the merger between Brahma and Antarctica, which gave rise to Ambev, representing the beginning of the company's operations. The year of 2005 is important because it is the year after the merger with the Belgian brewery Interbrew, considered one of the most important transactions on the trajectory of Ambev. The other years correspond to the most recent periods of the company's operations when it continued with the strategy to grow through M&As. It should be noted the growth of 289% and 449% of total assets and market value, respectively, in the period of 15 years.

5 Analysis of Indebtedness and Free Cash Flows of Ambev

As already mentioned, this study investigates the growth strategy oriented to M&As under the perspective of two funding sources: free cash flows and indebtedness. In order to ensure that indebtedness was not distorted by the company's growth, the debt ratio, gross debt divided by total assets (TA), was also used in this analysis, along with the company's gross debt. The same criterion was adopted to analyze the free cash flows, which are also divided by TA.

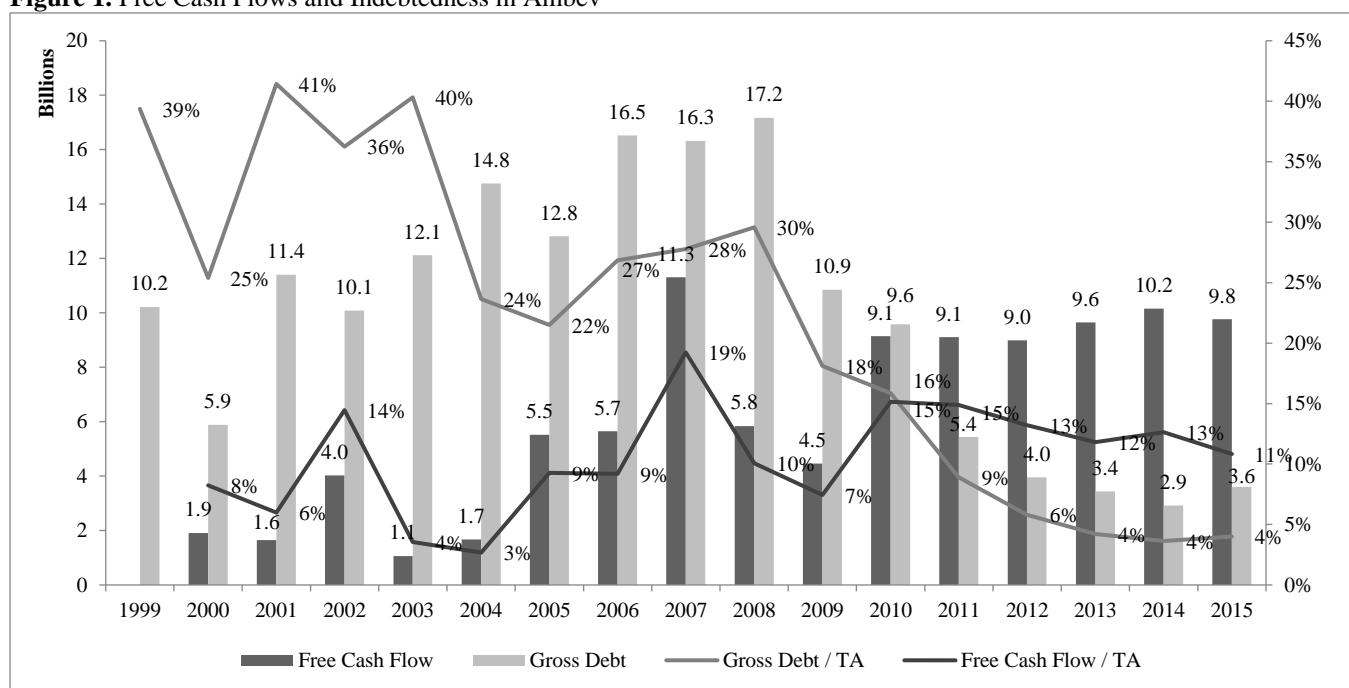
According to Ambev data (Figure 1), it is possible to verify that, initially, this company used

a more leveraged capital structure, presenting around 40% of third-party capital until 2003. With a drastic debt settlement starting in 2008, the company had, then, a lean structure, reaching an indebtedness rate of only 4% in 2015. As for self-financing, there was a growth trend, even in relation to the company's TA, which shows gains in terms of operational and/or managerial synergies. If, on the one hand, the period prior to 2008 was characterized by variations in the generation of free cash flows from operations,

after that year there was greater stability both in terms of amounts and in terms of percentages in relation to the TA, being that these flows tended to rise in relation to the past.

This change in capital structure is in line with the transactional character of Jensen (1986) and contrasts with the results of Cohn, Mills & Towery (2014), which verified a persistence of indebtedness in the acquiring companies after leveraged buyouts.

Figure 1. Free Cash Flows and Indebtedness in Ambev



Source: Own elaboration from Ambev financial data adjusted by the IPCA.

Initially, the growth driven by Ambev's M&As was financed, in large part, by borrowing resources, in agreement with Camargos and Barbosa (2005), while after 2008, indebtedness is drastically reduced with a larger generation of self-financing.

Table 4. Characteristics of Ambev's Free Cash Flows and Indebtedness at Different Moments

	First moment	Second moment
Indebtedness	Leveraged company.	Strong debt reduction.
Free Cash Flows	Smaller, more variable volume.	Higher than the previous period and more stable.
Related Theoretical Construction	Leveraged Buyouts	Free Cash Flow Theory

Source: Own elaboration.

Looking at the theoretical constructions about leveraged buyouts and Free Cash Flow Theory, one can relate the first moment with leveraged buyouts by making use of higher indebtedness to raise the resources that financed the growth driven by M&As of Ambev. Meanwhile, the second moment, starting in 2008, refers to the Free Cash Flow Theory, since, during this period, the debt was reduced along with a significant increase in the generation of self-financing.

6 Final Considerations

Since its origin, Ambev has adopted a growth strategy oriented to M&As. This practice was followed mainly in order to penetrate markets in several countries where this company had not yet acted. The purpose of this case study was to

investigate the growth driven by M&As of Ambev, emphasizing two sources of the company financing.

The Free Cash Flow Theory postulates that the manager would seek the growth of the company through acquisitions, applying, for this purpose, the free cash flows generated by self-financing. Another way to make acquisitions would be to finance them with resources raised through debt. In this case, such transactions could be based on the theoretical constructions on leveraged buyouts.

The results found in this study point out that, initially, the growth driven by M&As of Ambev was financed mainly by funds originated from indebtedness, which is in line with the leveraged buyout approach. From 2008 onwards, indebtedness was drastically reduced, while a greater generation of self-financing occurred, referring to the Free Cash Flow Theory. Thus, these results show that each of these approaches bears similarities to a specific period of Ambev's growth.

This case study unveils a growth model that can be strategically adopted by other companies. In this model, initially, the company would use financial leverage to perform acquisitions, expanding its market share, as well as obtaining productive factors, which would give it a competitive advantage. In a second moment the company could then use such additional capacities to generate more free cash flows and even direct some of them to reduce its indebtedness.

The present study is not unanimous in supporting that companies grow, initially, through debt. The theoretical construction called Corporate Life Cycle makes a similar association between the capital structure and certain stages in which the company may find itself. The main difference from the present study in relation to this other approach lies on how the company grows: driven by M&As.

In addition to help bring light to a strategy that can be applied by corporate managers, this study introduces the subject of the growth financing oriented to M&As in Brazil. Given this, there is room for several other analyzes. It is hoped, then, that future researches may go even further towards generating knowledge on this matter.

7 Implications on Future Researches

Studies are encouraged to investigate the financing of M&As considering a diversified and representative sample of these operations, which should be analyzed by means of statistical methods. Another possibility is to group the M&As according to the different economic sectors to which the companies involved in these transactions belong.

A breakthrough would be the observation of the generation of free cash flows not only in the acquiring companies, but also in the target companies. According to Jensen (1986), while the targets of leveraged buyouts should present significant free cash flows, in the Free Cash Flow Theory, acquisitions may include targets that show poor performance. In the case of Ambev, this analysis was not possible since a large number of the acquired companies were privately held and therefore did not make their financial information publicly available.

The approach of Jensen (1986) does not address M&As financed by issuance of shares. However, from a broader perspective, it is recommended that this form of financing be considered as well.

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