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OWNERSHIP STRUCTURE AND CORPORATE GOVERNANCE IN LATIN AMERICA*

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ABSTRACT

This paper provides an overview of corporate governance practices in Latin American countries, surveying the available empirical literature, reviewing the reports on the subject prepared by multinational organizations, and providing new data for ownership and control structures of companies in different Latin American economies. Like in other emerging economies corporate governance in Latin America is conditioned by the high level of ownership concentration and the profusion of industrial and financial conglomerates controlling several companies. This corporate structure generates an agency problem between controlling and minority shareholders, that is exacerbated when controlling shareholders hold a disproportionate amount of voting power in relation to their cash flow rights. New empirical evidence indicates that Latin American markets penalize excessive separation between control and cash flow rights held by controlling shareholders. In addition, legislation, regulations and the judiciary power in the region are less effective in promoting and enforcing good practices than in more developed markets. Legal reform has been recently introduced to improve minority shareholder protection and enforcement.

Key words: Corporate governance, Ownership structure, Latin America.
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Resumen

Este artículo presenta una descripción de las prácticas de gobierno societario en América Latina a través de una revisión de la literatura empírica disponible y de los informes preparados por los organismos multilaterales al respecto. Esta revisión se complementa con nuevos datos sobre las estructuras de propiedad y control de empresas listadas en las bolsas de los principales países latinoamericanos. En forma similar a otras economías emergentes, el gobierno corporativo en América Latina está condicionado por la alta concentración de la propiedad accionaria y la presencia generalizada de conglomerados industriales y financieros que controlan a la mayoría de las empresas de la región. Esta estructura corporativa genera un problema de agencia entre los accionistas controladores y minoritarios que es exacerbado cuando los accionistas controladores mantienen un derecho sobre el control de la compañía desproporcionado respecto a sus derechos sobre los flujos de caja de ésta. De hecho, evidencia empírica reciente muestra que los mercados latinoamericanos castigan a las empresas en las que se da esta situación. Por otro lado, consistentemente con la literatura académica, los informes preparados por diversos organismos multilaterales indican que los sistemas legislativos y judiciales en la región son menos efectivos que en mercados más desarrollados. Se observa, sin embargo, en los últimos años un proceso de reforma legal en la región que busca disminuir esta brecha.

In the last few years, corporate governance has become an area of interest for academics, policy makers, market analysts and businessmen in Latin America. This phenomenon is a natural response to a successful research agenda developed elsewhere during the nineties, to a list of corporate scandals occurred in North America, Europe, East Asia and of course Latin America, and to the growing interest in the subject shown by multilateral organizations exerting important influence in the region. In response to this growing interest, Latin American academics have produced several pieces of research about corporate governance in their home countries, policy makers have implemented legal reforms intended to improve minority shareholders protection, some companies have produced their own codes of best practice and investors have started to care about the governance of the firms they are investing in. A large part of this response has been supported

by funding an advice from multinational organizations such as the World Bank, the Inter-American Development Bank and the OECD.

The purpose of this paper is to provide an overview of the actual state of corporate governance in Latin American countries. In order to do so the paper provides a survey of the available empirical literature on the subject, complements the existing literature providing new data for companies in different Latin American economies and reviews the main conclusions and recommendations emanated of the reports prepared by multinational organizations.

A simple definition of corporate governance would refer to the set of mechanisms put in place in order to allocate control rights over the cash flows generated by a company, in order to permit the efficient and fair allocation of rents fostering investment in the company.[1] Consequently, the situation of corporate governance in a country or region depends on the type and quality of the mechanisms put in place. Stulz (2005) refers to the twin agency problems as the concurrence of the agency problem of corporate insider discretion and the agency problem of the state ruler discretion. The combination of these two agency problems greatly conditions the quality of corporate governance and the type of corporate structures existent in a country.

A standard classification of corporate governance mechanisms would divide them among those implemented internally to the firm and those working from the outside or external to the firm. The internal mechanisms include such aspects as the ownership and control structures in the company because these structures condition the relationship among different shareholders and between shareholders and the board. Pyramidation, for instance, will have a tendency to separate cash from control rights allowing some shareholders to hold a disproportionate fraction of the company's voting rights and will shape the composition of the board. Other internal mechanisms are the internal controls set by management to gather information from the different areas of the firm in order to present a correct picture of the company to the board of directors. On the other hand, external mechanisms include such aspects as the legal, regulatory and judiciary system that depend

[1] For an overview on what is corporate governance see Lefort (2003). Zingales (1998) provides a complete theoretical framework to understand the structure and benefits of corporate governance.

heavily on the general efficiency and honesty of the public sector. Other external mechanisms are built by the private sector in mature capital market settings through institutions such as directors associations, arbitration facilities, market analysts and other overseer systems.

Accordingly, this paper includes a review and comparison of ownership and control structures, including board composition, of Latin American companies, summarizing recent empirical and descriptive articles on corporate governance in Latin American economies such as the OECD White Paper and the World Bank ROSC reports. The article also presents new information based on data from ECONOMATICA,[2] annual reports from various companies and the 20-F forms filled with the SEC by Latin American companies listed in US markets (ADRs).

In general terms, the most important challenge faced when preparing a review and comparison of this type is the poor and dissimilar quality of information among different countries. Even information on listed companies is incomplete due to a relatively scarce empirical research at the country level and differing legal requirements about ownership disclosure. For instance, there are no region-wide papers on ownership structures in Latin American economies, and only the cases of listed companies in Brazil and Chile have been studied in some detail at the country level. The region also presents important disparities in ownership disclosure requirements. In most cases, notably Mexico and Argentina, not even listed companies are required to disclosure full ownership structures, while in others ultimate ownership is difficult to assess because of the prevalent use of holding companies as ownership vehicles. In many cases, the only reliable information is that reported in the 20-F forms filled by large Latin American companies listed in the US markets. Finally, there is no systematic information available on ownership and control structures of non-listed companies.

Despite these difficulties, it is clear that two main features characterize the ownership and control structures of most companies in Latin America. First, these companies present a very high ownership concentration. Second, many firms are directly or indirectly controlled by one of the numerous industrial, financial and mixed conglomerates that operate in Latin American economies. A conglomerate is a group of firms linked to each other through ownership relations and controlled by a local family, a group of

[2] ECONOMATICA is an Investment Analysis Data Base that provides financial and market information for listed companies in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.

investors acting in concert or, as has recently become more frequent, by a foreign company. Usually, conglomerates are controlled by the dominant shareholders through relatively complex structures including the use of pyramids, cross-holdings and dual class shares conducive to separate cash flow rights from control rights. Recent evidence for Chile and Brazil shows that market values of Latin American companies are affected by this type of control structures.[3]

The increase of foreign companies stakes in Latin American firms has been dramatic in some countries like Argentina in recent years. It could be argued that the increasing presence of foreign capitals in the region in the form of direct investment would cause a form of convergence of corporate governance practices through globalization. Interestingly, foreign investors tend to buy controlling stakes of Latin American companies and, consistently with Stulz (2005), become corporate insiders in order to protect themselves from the two agency problems previously mentioned.

High ownership concentration and conglomerate structures also importantly affect board room composition. Most board members in Latin American companies are related to controlling shareholders through family ties, friendship, business relationships and labor contracts.

The ownership structure of Latin American firms presents other interesting features. Despite massive privatization of state-owned companies, the state is still an important shareholder in many large companies throughout the region. In addition, in many cases, the privatization process importantly shaped the configuration of the ownership and control structures of the privatized companies.

There are no academic papers specifically studying the importance of external mechanisms of corporate governance in Latin American economies. However, one could get a general idea of the relative quality of corporate governance in the region through more general studies that include data from Latin American economies. For instance, Klapper and Love (2002) construct corporate governance indices using information produced by the Credit Lyonnais Securities Asia, for a list of 25 emerging economies. They find that Chile and Brazil score relatively well in firm level corporate governance, with Chile and Brazil ranking third and fifth respectively over a sample of 15 emerging economies. They also show that when considering

[3] See Lefort and Walker (2005a) for the case of Chile and Leal and Carvalhal da Silva (2005) for the case of Brazil.

country level judicial variables Chile ranks fourth and Brazil ranks sixth, with a score similar to that of South Korea well below that of countries like Singapore and Hong Kong but above India and Pakistan.

Other important characteristics of Latin American markets may have affected external mechanisms of corporate governance. First pension fund reform in the region has had a direct and indirect impact on corporate governance structures in Latin America.[4] Directly, pension funds are important minority shareholders in many companies in the region and elect members to their boards. Indirectly, pension fund reform has triggered capital markets and corporate law reforms which have contributed to overall improvement in corporate governance mechanisms.[5] Second, Latin American capital markets have experienced recently a wave of mergers and acquisitions where ownership of flagship domestic companies has been transferred to foreign companies. Finally, during the last decade or so many of the largest Latin American companies have been listed in North American markets through the ADR mechanism, while domestic trading was reduced, partly in response to the Asian crisis, implying lower turnover ratios and a very low level of new equity issues. However, this seems to have been a transitory phenomenon, since recently we have witnessed an increase in both new issues and traded volumes across the region.

The paper is organized as follows. In addition to this introduction, section I describes the ownership and control structures of Latin American companies, section II summarizes the existing evidence on board practices and composition, section III looks at more qualitative measures of corporate governance both at the country and firm level, while section IV looks at the evidence on the effect of corporate governance quality on firm market values. Section V concludes.

I. OWNERSHIP AND CONTROL STRUCTURES IN LATIN AMERICA

This paper examines corporate governance practices in six Latin American economies. Table I presents selected capital market indicators of these economies. In order to have a rough idea, while the level of annual per-capita income varies from US$2,000 (Colombia and Peru) to US$5,000

[4] See Walker and Lefort (2001).
[5] See Walker and Lefort (2001) and a more detailed explanation below.

(Mexico), the ratio of market capitalization to GDP varies from less than 20 percent in the case of Argentina to more than 100% percent in the case of Chile. As I have already mentioned, all six economies present a low turnover ratios, with Colombia being the lowest (1 percent) and Brazil and Mexico with 12 percent and 13 percent respectively. The number of listed firms ranges from 459 in Brazil to 74 in Colombia.[6]

A. Ownership concentration

La Porta *et al.* (1999) clearly document that, in most developing economies, there is a high level of ownership concentration. A simple measure of ownership concentration can be obtained by looking at the percentage of shares held by the largest shareholders of a set of companies. Table II provides such a measure for the single largest, the three largest and the five largest shareholders for a comprehensive set of listed companies from ECONOMATICA in Brazil, Chile, Colombia and Peru, and for the subset of ADR issuing companies in Argentina and Mexico. The evidence is clear. The largest single shareholder in these firms holds, on average, 53 percent of total shares, and the five largest shareholders add up to almost 80 percent of total shares. This evidence probably underestimates actual ownership concentration for two reasons. First, the large firms considered in the sample tend to be less concentrated than smaller firms and, second, usually several of the five largest shareholders represent, in fact, the same beneficial owner.

This is not, however, the only evidence available of the high level of ownership concentration in Latin American firms. Empirical evidence derived from slightly different samples of companies supports the results reported in Table II of this annex. For the case of large and listed Argentinean corporations, Apreda (2000) and de Michele (2002) report that among the 20 largest listed companies, controlling shareholders hold 65 percent of equity. Bebczuk (2005) looks at a sample of 54 large Argentinean companies finding that cash flow concentration in the hands of controlling shareholders amounts to 57 percent. In the case of Brazil, Leal (2002) find that, on average, the five largest shareholders of a typical Brazilian firm hold 58 percent of total capital. Leal and Carvalhal-da-Silva (2005) find that

[6] Figures from ECONOMATICA.

TABLE I
MARKET INDICATORS

Country	GDP per cap.(US$) (1) (2002)	GDP per cap.(US$) PPP ajusted (1) (2002)	Market Cap./GDP (2) (1997)	Total Value Traded/GDP (2) (1997)	Claims of Deposit money banks on private sector/GDP (2) (1997)	Claims of other intermediaries /GDP (2) (1997)	# of listed firms (3) (2002)	# of ADR (4) (2002)
Argentina	2400	-	0.11	0.04	0.15	0	152	24
Brazil	3580	7300	0.19	0.12	0.23	0.05	459	39
Chile	4590	9100	0.84	0.09	0.45	0.12	260	24
Colombia	2020	6060	0.13	0.01	0.16	0.15	74	3
Mexico	5070	8790	0.32	0.13	0.22	0.03	201	37
Peru	2080	4660	0.11	0.04	0.09	0.01	175	2
Average	3290	7182	0.28	0.07	0.22	0.06	220.2	21.5

(1) Country Risk Guide, Coface (2003)
(2) Dermigüç-Kunt, Asli and Ross Levine (2001), "Financial Structure and Economic Growth". MIT Press. (Data of 1997)
(3) ECONOMATICA
(4) www.NYSE.com

controlling shareholders receive, on average, 54 percent of cash flows accrued by shareholders. Similar results are found in Lefort and Walker (2000c) for listed firms in Chile. They report that the five largest shareholders hold 80 percent of shares. For the case of Colombia, recent evidence provided by Gutierrez, Pombo y Taborda (2005) show that ownership concentration reached 65 percent by the year 2002. Finally, Babatz (1997) confirms our findings on ownership concentration in Mexico. The largest shareholder owns 65 percent of company shares of the average listed company, and 49 percent in the case of ADR-issuing firms.

B. Ownership and control structure

The very high levels of ownership concentration described above clearly imply that, in Latin American firms, corporate control is tightly exercised by majority shareholders. Therefore, a focus of the corporate governance concern in the region is possible divergence of interest between majority and minority shareholders. Such divergence of interest can be exacerbated by the use of structures designed to separate control rights from cash flow rights. In this sense, an important feature of corporate control structures in the region is the widespread presence of industrial, financial and mixed conglomerates. A conglomerate is a relatively complex corporate structure used by a common owner or group of owners in order to control a wide variety of assets belonging to different listed and non-listed firms. Controllers of Latin American conglomerates use these devices, among other things, to separate ownership from control through pyramid structures, dual class shares and cross ownership.

The identity of controlling shareholders has been changing during the last few years. Although domestic families are still very important, control has been passing to teams of executives and to foreign companies. In most cases, the only relevant minority shareholders are institutional investors both domestic and foreign. Tables III and IV present evidence regarding the identity of controlling shareholders in large listed Latin American companies, the degree of affiliation to conglomerates and the extent of the separation of cash flow and control rights. The tables were constructed using a variety of sources that are detailed below.

Although, conglomeration is the most pervasive form of corporate structure in Latin America, different Latin American countries present different patterns of conglomerate control. Apreda (2000) and de Michele (2002)

TABLE II
OWNERSHIP CONCENTRATION

Country	Sample (2002)	% of largest shareholder (2002)	% of 3 largest shareholders (2002)	% of 5 largest shareholders (2002)
Argentina**	15	61%	82%	90%
Brazil*	459	51%	65%	67%
Chile*	260	55%	74%	80%
Colombia*	74	44%	65%	73%
Mexico**	27	52%	73%	81%
Peru*	175	57%	78%	82%
Average	168.3	53%	73%	79%

* Data from ECONOMATICA

** Data from 20-F ADR filings.

provide a simple description of ownership structure in large listed Argentinean corporations. As already mentioned, they report that among the 20 largest listed companies, controlling shareholders hold 65 percent of equity. The identity of controllers has dramatically changed in the last 5 years with foreign ownership increasing dramatically. Bebczuk (2005) analyzes ownership patterns on 56 large listed Argentinean companies. He finds that 29 are foreign-controlled while 25 are controlled by a local family and there are only two state-owned companies. Pyramid structures are widely employed in Argentina. Khanna and Yafeh (2000) detect 11 conglomerates participating in the ownership of large listed Argentinean firms. Bebczuk (2005) indicates that 20 of the 54 companies considered are linked to one of the many conglomerates that are structured around a pyramid. In addition to pyramids, Argentinean companies also use dual class shares to separate cash from control rights. Beczuk (2005) finds 6 companies using this mechanism, but there are no precise measures of the extent of this practice economy-wide. Using data of the 24 Argentinean firms that have issued ADRs, I find 93 percent of affiliation to groups through pyramids but little use of non-voting shares (only 3.9 percent). In these companies, the controlling group has rights, directly or indirectly, over 68 percent of firms' cash flows. Although, one of the main purposes of pyramids and dual class shares is to separate cash from control rights, there is no clear evidence of how much of this is accomplished by Argentinean corporate structures. Bebczuk (2005) indicates that while cash flow concentration is around 57 percent, voting rights concentration reaches, on average, 63 percent.

In the case of Brazil, the most salient feature of control structures is the widespread use of non-voting shares in order to separate control from cash flow rights. Distortions introduced by the tax and regulatory regime during the eighties encouraged the issuance and purchase of non-voting shares in that country. Brazilian law allowed companies to issue dual class shares in a ratio of up to 1/3 of voting shares to 2/3 of non-voting shares.[7] Leal et al. (2000), Leal and Oliveira (2002), Siffert (2002) and Leal and Carvalhal (2005) describe in some detail the ownership structure of Brazilian companies. As in the other countries in the region, they find that conglomerates are the predominant form of corporate structure in Brazil. Khanna and Yafeh

[7] Recently, however, the law was amended decreasing the proportion of new non-voting shares to 50 percent of total capital.

(2000) found 38 conglomerates participating in the ownership of large listed Brazilian firms. Using data on the 39 ADR Brazilian issuers, I find 89 percent of affiliation with conglomerates through pyramids. However, dual class shares are the most common way of separating voting from cash flow rights in Brazilian firms. Almost 90 percent of 459 listed Brazilian firms reporting to ECONOMATICA have non-voting shares that represent 120% of total voting capital. In spite of the substantial use of dual class shares and pyramids, Brazilian controlling shareholders hold more equity than strictly needed for control. In these companies, the controlling group has rights, directly or indirectly, over 60% of firm's cash flows. Leal and Carvalhal (2005) use a large sample of Brazilian companies to show that, mainly through dual class shares, controlling shareholders of Brazilian companies hold over 90 percent of voting rights.

In terms of the identity of controlling shareholders, these studies show that when considering the 100 largest non-financial firms in Brazil, 2 are characterized by disperse ownership, 29 are controlled by a family (local group), 37 are controlled by a foreign firm and in 32 the controller is the federal government. Table III presents these results in percentage terms.

Like other Latin American countries, Chile presents a very high ownership concentration and a corporate structure dominated by the presence of conglomerates.[8] Lefort and Walker (2000c) indicate that 68 percent of listed non-financial Chilean firms are controlled by one of the approximately 50 non-financial conglomerates, representing 91 percent of the assets of non-financial companies listed in Chilean stock markets. At present, approximately half of these 50 conglomerates are controlled by a foreign multinational company.

Chilean conglomerates are structurally relatively simple. The most common way of separating voting from cash flow rights is through simple pyramid structures with only 1/3 of affiliated listed companies being second or higher tier in the pyramidal structure. In contrast, only 7.5 percent of listed firms have dual class shares while cross-holdings are forbidden by law.[9] Although controlling shareholders of Chilean companies tend to separate their voting rights from their cash flow rights though the use of these

[8] Lefort and Walker (2000c), Agosín and Pastén (2000) and Majluf et al. (1998) are recent papers on conglomerates and corporate structure in Chile.

[9] Firms refrain from issuing dual class shares in order to attract pension fund investments and avoid being penalized by risk rating agencies. See Lefort and Walker (2000c).

pyramids, as in the Brazilian case, they usually hold more equity than strictly needed for control. In fact, on average, 57 percent of consolidated equity is directly or indirectly owned by controllers. Many times, beneficial ownership is difficult to ascertain due to the extensive use of private holding companies as investment vehicles due to their tax efficiency.

Although deficiencies in data make it impossible to present detailed and definitive conclusions about ownership structure in Mexico, Babatz (1997), Castañeda (2000) and Husted and Serrano (2001) shed some light for the case of this country. As in the other markets considered in this study, ownership concentration is very high in Mexico and conglomerates are the most common form of corporate structure. These hold, on average, 65.5 percent of listed companies shares. In the Mexican case, separation of ownership and control is achieved through both dual class shares and pyramid structures. Table IV shows that 37 percent of listed firms have issued non-voting shares and 59 percent of listed firms belong to a pyramid structure. There are several classes of shares issued by companies. Usually, class A shares convey full voting rights and are tightly held by the controlling family. Most traded stocks have limits regarding voting rights and are held by the minority interest. Foreign ownership has also increased lately. According to Babatz (1997), 18 percent of Mexico's 150 largest listed companies are foreign-controlled.

C. *Institutional investors*

Individual minority investors are unimportant in most Latin American companies. However, institutional investors, in particular pension funds, do play a role in corporate governance. Early pension fund reform in Chile followed by later reforms in Argentina, Colombia, Peru and Mexico gave private pension funds an important role as suppliers of capital. In addition, pension reform has triggered capital market and corporate law reforms that have helped to improve overall minority shareholders protection. Walker and Lefort (2001) provide several examples that indicate that pension reform relates to the accumulation of "institutional capital"[10], creates a more dynamic legal framework[11], increases specialization, innovation, transparency and integrity of capital markets, and also improves corporate governance

[10] See Valdés and Cifuentes (1990).
[11] Iglesias (1999) cites 25 legal reforms in Chilean capital markets that were triggered by pension fund investing needs.

TABLE III
CONTROLLER IDENTITY

Country	Domestic-private Controlled	Foreign Controlled	State Controlled	Disperse Ownership	# of Groups (1) (1997)	% of affiliation to groups (2) (2002)
Argentina*	38.6%*	59.1%*	2.3%*	0%*	11	93%
Brazil**	43%**	33%**	21%**	3%**	38	89%
Chile	69%	30%	0.8%	0%	50***	68%
Colombia					7	50%
Mexico		18%****			14	72%
Peru					5	100%
Average					19.2	79%

(1) Khanna and Yafeh (2000) "Business Groups and Risk Sharing Around the World". Working Paper. Except Chile.

(2) For Argentina, Brazil, Colombia and Peru, data from 20-F ADR filings.

* Apreda (2000). 40 largest firms.

** Siffert, Nelson "Governança Corporativa: Padroes internacionais e evidencias empiricas no brasil nos anos 90". Working Paper.

***Lefort, Tarziján, Espinosa (2003) "Corporate Investment in Chile: Group Effect". Pontificia Universidad Católica de Chile .

**** Babatz (2000).

practices[12]. They also present statistical evidence consistent with the hypothesis that pension fund reform reduces firms' cost of capital, lowers security-price volatility, and increased trading volumes.

In several cases, pension funds, individually or as a group, have achieved large enough holdings of shares to justify an important role as minority shareholders, thus overcoming the classical free rider problem. In addition, because of the nature of the funds administered by pension fund managers and their political influence, they have become important opinion leaders in issues regarding corporate governance and minority shareholders protection. Examples of this type of influence by institutional investors are the ENERSIS and Terra cases in Chile.[13] More specifically, Walker and Lefort (2001) show that by the year 2000, pension fund holdings of corporate bonds and stocks as a fraction of market capitalization accounted for 15.9 percent in Chile, 24.8 percent in Argentina and 32.1 percent in Peru. In the case of Mexico, because of both the short life of the pension reform and the channeling of their investments into indexed government bonds, domestic institutional investors still play a very limited role in private capital markets (Husted and Serrano (2001)). In Brazil, Siffert (2000) indicates that, sometimes because of the privatization process, there has been an increase in companies displaying shared control, where institutional investors, both domestic and foreign, hold large stock blocks and act as relevant, though not controlling shareholders.

In summary, Latin American companies present high ownership concentration and a corporate structure characterized by a tendency to separate cash from control rights through pyramid structures under the control of an economic group and dual class shares. In some countries, institutional investors have become an important minority shareholder.

[12] For example, in conjunction with the country's pension fund reform, a new bankruptcy law was implemented in Argentina (Law 24.552 of 1995). In Chile, the Association of Pension Funds (ASAFP) notifies the authorities and influences public opinion about corporate governance situations that are negative for pension funds. Also pension fund managers are typically required by the Superintendency of Pension Fund managers (SAFP) to file reports regarding events or transactions by security issuers that may have negative effects on pension fund investments. In Peru, being "AFPable" became a new status forsecurities issuers, requiring more information transparency (Ramos, 1999).

[13] In the first case, a mutual fund manager opposed the bid by ENDESA Spain and called for an extraordinary shareholders meeting. In the second, pension fund managers informed the regulator about the poor conditions of the sale of Terra to Telefonica Spain.

II. BOARD PRACTICES AND COMPOSITION IN LATIN AMERICA

Corporate law in most Latin American countries explicitly indicates that boards are the main decision making body of a company and that board members owe duties of loyalty and care to all shareholders. However, as a consequence of the high ownership concentration observed in most firms in the region, boards in Latin American countries tend to be much weaker than in the US or UK, and constitute a poor governance mechanism. In general terms, boards in Latin America serve mainly an advisory function for controlling shareholders, include very few independent board members and exhibit few if any functioning committees.

Independence is an important characteristic for a board member. Hillman and Dalziel (2003) argue that a board room has to present an adequate balance between independent and non-independent board members in order to provide both monitoring capacities and strategic resources to the company. In recently adopted rules, the SEC made the distinction between non-independent and affiliated board members. While a non-independent board member is a person related to the company through a job or some other business or material relationship such as being a supplier or a competitor[14], an affiliated member is a major shareholder of the company, a controlling shareholder or a person related to the controlling shareholder of the company. However, in Latin America, because the extensive use of pyramid structures and the important level of involvement of controllers in the day-to-day business of the company, affiliated board members tend to be also non-independent as defined by the SEC.

There is very little systematic information on board composition in Latin American countries. For many countries, the only available information is reports on 20-F forms filed with the Securities and Exchange Commission. Table V summarizes our findings through various sources. On average, Latin American board rooms have less than 8 board members and less than half of them can be considered both independent and non-affiliated. There are a few studies for Brazil, Chile, Mexico and Venezuela that help to complement this result.

The structure and functioning of boards in Brazil is analyzed by Ventura (2000), Leal and Oliveira (2002) and Dutra and Saito (2001). As noted

[14] A non-independent board member is prone to present conflict of interests.

above, they find that Brazilian boards serve mainly an advisory role and their members tend to be affiliated with the controlling group. Specifically, 49 percent of board members are affiliated with controlling shareholders and less than 20 percent of directors would qualify as independent using US standards. Moreover, CEOs tend also to be affiliated with controllers and only 17 percent of companies have standing board committees. Recently, Leal and Carvalhal (2005) produced a corporate governance survey consisting of 20 questions applied to over 400 companies. Their findings reveal that in 36 percent of the firms the chairman of the board and the CEO were the same person, and 70 percent of the boards are not clearly made up of a majority of outside directors. Moreover, most boards do not have committees and most companies have not implemented the mandatory fiscal board formd with directors elected by minority shareholders.

Lefort and Walker (2000c), Iglesias (1999), Majluf *et al.* (1998), Spencer Stuart-PUC (2000) and Lefort and Walker (2005) look at board composition and functioning in Chile and reach similar conclusions. In particular, the survey prepared by Spencer Stuart-PUC shows that only 55 percent of directors would qualify as independent and non-affiliated using the SEC definitions, that is, they have no direct family or work relationship with the company or related companies. However, the number of truly independent board members is almost certainly much lower since many self-regarded independent directors have an important part of their income provided by the controlling shareholders through other board memberships or consulting activities. Lefort and Walker (2000c) show that when considering the 5 largest conglomerates, more than 80 percent of directors can be considered affiliated to the controlling shareholders. Even in the case of companies where pension funds own shares, on average, only 10 percent of board members are actually elected with pension funds votes.[15]

Additional evidence indicates a lack of monitoring activities of Chilean boards. Spencer Stuart-PUC reports that only 29 percent of boards of directors in Chile have established standing board committees. Lefort and Walker (2000c) look at interlocking boards in Chilean conglomerates and find, on average, that each board member of a listed firm affiliated to a conglomerate sits on 1.6 board rooms. In addition, conglomerates do not share directors. Only 3 percent of directors out of a total sample of 1,530

15 Iglesias (2000).

sit on boards of two or more companies belonging to different conglomerates. More recently, Lefort and Walker (2005) conducted a company survey for almost 120 large listed Chilean firms. They detected a very low level of board involvement in committees. Less than 5 percent of the largest firms of the country have a corporate governance committee and only 14 percent had compensation or nomination committees. In only 21 percent of the companies the chairman of the board is an independent and non-affiliated board member. In 70 percent of the boards of the largest Chilean companies there are board members that are also executives or board members of other companies of the same group, indicating a high degree of board interlocking and lack of independence of board members.

Things are not very different in Mexico. As indicated by Babatz (1997) and Husted and Serrano (2001), appointing directors in Mexico is largely a family affair. A simple look at board composition shows that 53 percent of directors are either top executives of the firm, of other firms of the group, or relatives of such executives. However, the lack of independence is probably worse because of political dependence and other kinds of relationships such as the local "compadrazgo" (godfather relationships).

A recent paper by Garay and Gonzalez (2005) looks at director turnover in Venezuela. They also carry a company survey on corporate governance practices and find results similar to the other countries. In general, boards are formed by non-independent board members and present a high level of board inter-locking. There are very few functioning committees and ownership and remuneration of board members and senior executives are not adequately disclosed.

In summary, consistently with the control structure of Latin American companies, the evidence shows that boards in the region are likely to be dominated by the controlling shareholders and, therefore, tend to have an advisory role to the controlling shareholders.

III. EXTERNAL MECHANISMS OF CORPORATE GOVERNANCE IN LATIN AMERICAN COUNTRIES

In the last few years, corporate governance in Latin America has experienced an important improvement in response to a list of corporate scandals and the interest in the subject shown by multilateral organizations exerting important influence in the region. This new scenario triggered legal

reform in several countries and more awareness across the region. In particular, policy makers have implemented legal reforms intended to improve minority shareholder protection, some companies have produced their own codes of best practice and investors have started to care about the governance of the firms they are investing in. Therefore, in general terms, the region has experienced a relentless improvement in several of the external mechanisms of corporate governance.

A summary of the actual situation of corporate governance in the region can be found in the White Paper of Corporate Governance. The OECD and the World Bank started during the late nineties a series of Round Tables in Corporate Governance in Latin America attended by policy makers, institutional investors, market participants, and the business and academic communities. The Round Tables brought awareness of the problems that existed in the region, set a series of reforms in motion and gave origin to the Latin American White Paper on Corporate Governance. The White Paper evaluated corporate governance practices in the region and presented a series of recommendations in different areas including information disclosure, regulatory practices and stakeholders rights.

Regarding legal reform, a significant amount of information on the overall legal frameworks in place in many Latin American countries is already available. For example, the International Bar Association published a comparative study called "Corporate Governance in 34 jurisdictions worldwide: 2005", and the World Bank produced the Corporate Governance Reports on Observance of Standards and Codes (ROSC) for Chile, Colombia, Mexico and Peru. Most Latin American countries have implemented some sort of legal reform related to corporate governance, improving company disclosure and minority shareholders protection. In the case of Chile, the OPA Law amended both the Securities Market Law and the Corporations Law. The amendment was aimed at improving corporate governance and the regulation of takeovers. The reform introduced changes in five areas of the law. First, the market for control was regulated requiring that transactions involving changes of control were performed through a tender offer under a version of the equal opportunity rule. Second, the regulator increased the information and disclosure requirements to listed corporations, especially in the case of transactions with related parties. Third, large listed corporations were required to form a committee with a majority of board members non related to the controlling shareholder. The duties of this

committee were specified by law. Fourth, share repurchases were allowed in order to implement stock option packages as an incentive to executives. Fifth, equal treatment of foreign shareholders was guaranteed by law especially in matters regarding voting procedures. Although the amendments included a transitory rule that allowed firms to postpone the adoption of the new regulations, the transitory rule finally phased out in January 2004.[16] In the case of Colombia, Resolution 275 of 2001 addressed corporate governance issues. Among others, the resolution established requirements for companies to be eligible for investment by pension funds and required companies to establish mechanisms to protect shareholders and disclose them trough a company code of corporate governance. Mexican laws were amended earlier. Corporations Law was amended in 1996 introducing the basic requirements for the equitable treatment of shareholders. In 2001 the Securities Market Law was also amended increasing information requirements for listed companies among others. In the case of Peru, the two main bodies of the law were passed in 1997 and include several aspects of shareholder protection although no specific corporate governance amendment has been introduced.

Private sector initiatives have complemented legal reform improving external mechanisms of corporate governance. For instance, business organizations in Colombia, Mexico and Brazil have given origin to codes of best practice that comprise a number of standard recommendations to companies in order to improve corporate governance. In some cases, like Colombia, regulators require companies to disclose to what extent are complying with the recommendations. Another manifestation is the creation of private institutes of directors such as the Brazilian and Mexican and Centers for Corporate Governance such as the ones in Argentina, Colombia and Chile.

In summary, during the last few years the degree of awareness on the importance of good corporate governance practices has increased in the region. This has resulted in several initiatives, both from the public and private sector, to reform the legal and regulatory frameworks and improve the overall quality of external mechanisms of corporate governance.

[16] See Moran (2003).

TABLE IV
SEPARATION OF OWNERSHIP AND CONTROL

Country	% de firms with non voting shares (1) (2002)	Non voting/ voting shares (2) (2002)	% of firms in pyramids (3) (2002)	% cash flow rights of controller (2002)
Argentina	3.9%	0.14	93%	68%
Brazil	86.9%	1.29	89%	60%
Chile	7.2%	0.07	68%	57%**
Colombia*	7.1%	0.09	50%	-
Mexico	37.8%	-	72%	59%
Peru*	61.0%	0.25	100%	-
Average	34.0%	0.37	79%	61.0%

(1) Number of firms with preferred shares/number of total firms (Economática)
(2) Number of prefered shares/Number of common shares (Economática)
(3) Data from 20-F ADR filings.
* Only two firms in the sample.
** Lefort and Walker (2000b) "Ownership and Capital Structure of Chilean Conglomerates: Facts and Hypotheses for Governance". Abante.

TABLE V
BOARD STRUCTURE

Country	# of board members (2002)	% of independent members (2002)	Board Members/ Board Seats (2002)
Argentina*	8.1	38.8%	1.20
Brazil*	8.5	28.6%	1.10
Chile**	7.6	55.0%	1.60
Colombia***	5.0	50.0%	-
Mexico*	11.4	54.0%	1.09
Peru***	6.0	62.4%	-
Average	7.8	48.1%	1.25

* Data from 20-F ADR filings.
** Spencer-Stuart (2000) "Directors Guide"
*** Data from 20-F ADR filings (few firms (2))

IV. CORPORATE GOVERNANCE AND FIRM PERFORMANCE

In spite of recent improvements, corporate governance in emerging economies such as the ones in Latin America is still lagging behind practices in more developed markets. Part of the problem has to do with relatively worse institutions including legal and regulatory frameworks at the country level. In addition, practices at the firm level may be, on average, worse than in companies operating in more developed markets. For instance, the high level of ownership concentration that tends to diminish the standard agency problem between managers and shareholders may be generating more serious agency problems between controlling and minority shareholders. Hence, a natural question arises: Do corporate governance practices at the firm level affect company market valuation and performance in the Latin American setting?

Recent empirical literature exploiting new databases at the country level has shown that policies intended to reduce potential agency conflicts between controlling and minority shareholders are valued by the market. This evidence is consistent with the hypothesis that concentrated structures or economic groups are prone to carry inefficient investment and generate minority shareholder expropriation, especially when the controlling shareholders of these groups exercise control through complex mechanisms such as the pyramid schemes, cross-holdings and dual class shares discussed above. In those cases, the agency problem is exacerbated because, on the one hand, ownership concentration insulates the controller from the market for corporate control, and on the other hand, control is executed by a shareholder that holds a relatively small fraction of the cash-flow rights (Bebchuck (1999), Bebchuk et al. (2004) and Wolfenzon (1999)).

Interestingly, many of these studies also recognize that one of the most salient characteristics of concentrated ownership structures in emerging economies is that they are persistent in time, and able to adapt to most changing situations. Khanna and Palepu (1999) for India and Chile and Lefort and Walker (1999b) for Chile have shown that conglomerates have been able to grow and increase their scope and self-intermediation practices even during times of fierce economic reform and deregulation. This kind of evidence has supported a more favorable view of conglomerates in emerging economies sustaining that economic groups are a natural and efficient way for firms to deal with imperfect capital markets, poor institutions,

corruption and other imperfections that plague emerging economies. In this context, economic groups arise in order to fill the voids left by (or to take advantage of) poor institutions. In particular, internal capital markets, that is, the headquarters allocation of funds to the different business units of the conglomerate creates value in a credit constrained world. Other financial synergies arise because of the possibility for conglomerates to liquidate assets of specific units in response to a general downturn, and because of risk diversification that might be valuable to investors in economies with imperfect capital markets. There are also operational synergies generated through conglomeration. They might be related to economies of scale and scope in product and factor markets arising because of poor basic services like power, postal or others. It might be also related to poor consumer protection and the advantage of group branding. One of the most cited reasons for conglomerates in emerging markets is the advantage they create to deal with a corrupt government, a highly regulated economy and a poor judiciary system (Khanna and Palepu (1997)).

In particular, Khanna and Palepu (1999), Lefort and Walker (1999b, 2000, 2005) and Lefort (2005) analyze the effect of ownership structures and corporate governance in firm performance in the case of Chile. Lefort and Walker (2005) look at 180 non-financial companies listed in the Santiago Stock Exchange from 1990 to 2003. They find a positive correlation between the degree of coincidence between cash and control rights held by the controlling shareholders and the market value of the company. The coefficients obtained in the regressions imply that a one standard deviation increase in the degree of coincidence, which represents an increase of 21.5 percent, is associated with an increase in stock price ranging between 10 and 58 percent depending on the specification. Lefort (2005b) finds that other indicators of the extent of conflict of interest in the company such as board interlocking and executive also explain company market value.

Valadares and Leal (2000) and Leal and Carvalhal (2005) provide similar evidence for Brazil using a panel of over 450 companies over the years 1998 to 2002. They find that a 1 point increase on a corporate governance index ranging between 0 and 24 causes a 6 percent increase in firm value. They also find that disclosure is the most relevant factor of corporate governance practices at the firm level. In the case of Colombia, Gutierrez, Pombo and Taborda (2005) analyze a sample of 108 non-financial for the 1998-2002 period. They show that the presence of a large shareholder is

positively valued by the market, and that increases in the degree of separation between cash and control rights tend to decrease company value. However, they do not find any evidence that other dimensions of corporate governance practices at the firm level affect the market value of Colombian companies. Bebczuk (2005) analyzes the case of Argentina looking at 65 large Argentinean companies over the years 2002 and 2003. His study provides some evidence that good corporate governance practices at the firm level are associated to a higher ROA and Tobin's q. Moreover, a high degree of separation between cash and control rights in the hands of the controlling shareholder are associated with lower firm performance and less benefits from improving corporate governance practices.

A novel approach to ascertain the effect of corporate governance on company valuation in Latin America is developed by Cruces and Kawamura (2005). They analyze transactions carried on the most liquid stocks of the main Latin American countries, looking for potential use of insider information. The working hypothesis is that as corporate governance improves, the informational gap between controlling shareholders and uninformed traders is reduced. Consistently, they find that insider trading probabilities (ITP) are higher around corporate announcements. They find that the market penalizes companies that present high ITP and interpret this finding as evidence that ITP is a proxy for unobserved bad corporate governance practices.

V. SUMMARY AND CONCLUSIONS

This paper has surveyed the existing academic literature on corporate governance in Latin American economies. Although still scarce, there has been an increase in the last few years of empirical articles looking at corporate governance practices at the firm level in the region. A reason for the relatively limited number of existing empirical studies is the poor quality of firm level data in Latin American countries. In addition, the quality of information is very heterogeneous across countries, making hard to compare corporate structures and corporate governance practices across countries. In spite of these difficulties, this paper provides the first region wide overview to these topics.

Like in other emerging economies corporate governance in Latin America is conditioned by the high level of ownership concentration and the profusion of industrial and financial conglomerates controlling several companies. In

many cases control is exercised through a combination of pyramid structures, dual class series and cross-holdings, resulting in an even higher concentration of voting power in comparison to the concentration of cash flow rights. In general, the resulting corporate structures provide adequate incentives in order for the controlling shareholders exercise tight control over management reducing the standard agency problem common to disperse ownership corporations. However, the concentration of control on a small group of shareholders generates an agency problem between the controlling shareholders acting both as shareholders and as managers and minority shareholders. This agency problem is exacerbated when, as it usually happens, controlling shareholders hold a disproportionate amount of voting power in relation to their cash flow rights.

Consistently with the control structure observed, the evidence shows that boards in the region are likely to be dominated by the controlling shareholders and, therefore, tend to have an advisory role to the controlling shareholders. Boards in Latin America have very few directors that are truly independent with respect to the controlling shareholders and, thus, audit or corporate governance committees in charge of overseeing related party transactions are a clear necessity in the region.

In addition, cross country studies have shown that companies in Latin American countries tend to employ worse corporate governance practices than companies in more developed capital markets because legislation, regulations and the judiciary power in the region are less effective in promoting and enforcing good practices. However, in response to this diagnostic, several countries have recently introduced reforms to Corporations and Securities Markets Laws in order to improve minority shareholder protection and enforcement. However, in this area progress is not uniform. Countries like Chile and Brazil have led the reforming effort and also show the best corporate governance practices at the firm level in the region. Data for them is also relatively abundant. In opposition, Mexico and Argentina are still lagging behind and more efforts must be made in order to improve corporate governance practices in their companies. In those cases, an important first step is requiring more disclosure of ownership structures. This information will not only help minority shareholders but also allow more research in order to understand the control structures operating in their companies.

Investors in Latin America understand the importance of good

corporate governace. New empirical evidence has shown that Latin American capital markets are considering some aspects of corporate governance practices at the firm level in the valuation of the companies traded in stock markets. For instance, the evidence found for several countries clearly indicates that markets penalize excessive separation between control and cash flow rights held by controlling shareholders.

There is no evidence yet regarding the impact of other dimensions of corporate governance on company valuation. As more data are gathered the challenge is to make inter-country comparisons in order to understand the specific characteristics of corporate governance more valued and/or penalized by the country. For instance, while Brazilian controlling shareholders tend to separate cash flow from control rights through the generalize use of dual class shares, Chilean economic groups use pyramid structures. A natural question arises: for a given level of separation between cash and control rights, are both mechanisms equivalent to the market?

In conclusion, we now know that good corporate governance is valued by Latin American capital markets and that, although, heterogeneously, companies across Latin America are slowly improving their corporate governance practices. In many cases the sharp differences among countries are explained by the differences in the extent of legal reform. Despite this, we still have many important unanswered questions about the different dimensions of corporate governance in Latin America.

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