

**A COMPARATIVE ANALYSIS OF CORPORATE
GOVERNANCE SYSTEMS IN LATIN AMERICA:
ARGENTINA, BRAZIL, CHILE, COLOMBIA AND
VENEZUELA**

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RUNNING HEAD: CORPORATE GOVERNANCE IN LATIN
AMERICA

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INTRODUCTION

This chapter analyzes corporate governance systems in five Latin American countries: Argentina, Brazil, Chile, Colombia and Venezuela. We account for the broader institutional environment by explaining changes over time as well as existing corporate governance systems. We use a stakeholder definition of corporate governance that includes examining insiders such as owners and boards of directors as well as outsiders such as employees. This corporate governance perspective allows for a systematic cross-national comparison.

There exists an extensive literature on the Anglo-American corporate governance system, particularly from the finance field (e.g. Shleifer and Vishny, 1997; Keasey, Thompson, and Wright, 1999) as well as on comparative corporate governance among industrialized countries (e.g., Prowse, 1995; Rhodes and van Apeldoorn, 1998; Weimer and Pape, 1999; AMR special issue on corporate governance, 2003; Grandori, 2004; Gospel and Pendelton, 2005; Aguilera et al., 2008). There have also been some comparative corporate governance studies on Eastern Europe (e.g. Federowicz and Aguilera, 2003) and East Asia (e.g. OECD 2001; Zhuang and Edwards, 2001; Jacoby, 2004). This chapter seeks to fill a gap in comparative corporate governance research by

systematically analyzing the main corporate governance characteristics in the five largest countries in Latin America¹. Little comparative corporate governance research has been done on this region of the world despite its geographic importance and recent economic interest in creating a Free Trade Area of the Americas.

Studies of corporate governance examine how the rights and responsibilities within firms are distributed (Aguilera and Jackson, 2003). The institutions of corporate governance are key factors in the long-term economic development of a country. These institutions have two main objectives: to stimulate the performance of corporations through a business environment that motivates productivity and to ensure corporate conformance between the interests of investors and society (Oman, 2003). Several scholars have discussed the positive relationship between effective national corporate governance systems and firm performance in emerging markets. For example, Klapper and Love (2002) demonstrate that efficient governance is highly correlated with better operating performance and market valuation, and Doidge, Karalyi, and Stulz (2004) show how country characteristics are key explanatory variables in governance ratings across firms in less-developed countries as opposed to firm characteristics in developed countries.

¹ We exclude Mexico because it is part of a very different economic system given its close relationship and dependence with the U.S.

This chapter examines the largest and most productive five countries of South America (Argentina, Brazil, Chile, Colombia and Venezuela). These are developing economies that have in common a tumultuous political and economic history of dictatorships and economic crises. Yet, these countries are in the process of modernizing their corporate governance systems, either as a condition in continuing to receive international aid or simply as a strategy to attract more foreign direct investment.

The comparative nature of this chapter allows us to tackle indirectly an important debate within corporate governance, that is, whether there is a convergence towards the Anglo-American model (Hansmann & Kraakman, 2001; Thomsen, 2004). This question has been addressed for transition economies such as Eastern Europe (Aguilera and Dabu, 2005), and more generally emerging markets. For example, an empirical analysis of 24 emerging countries by Khanna, Kogan, and Palepu (2002) indicates that corporate governance convergence is not imminent, although there is as yet no general consensus. Our chapter contributes to this debate by showing that, indeed, there is not full convergence as Latin American countries modernize their corporate governance system.

In this chapter, we first review the main political and economic trends of each of the five countries. This might seem unconventional for a study of corporate governance but since these

five countries are in emerging markets, we believe it is particularly relevant to stress their broader political and economic conditions that undoubtedly shape their respective corporate governance patterns. Second, we systematically compare different aspects that define the systems of corporate governance in these countries.

ECONOMIC AND POLITICAL BACKGROUND

Outside observers tend to lump Latin American countries into a single category, when in reality these countries encompass a wide range of economic, political and social histories. For example, Lenartowicz and Johnson (2003) show that common perceptions of Latin America as a culturally homogeneous region are stereotypical and incorrect. Table 1 highlights three key political events for each country: enactment of the latest constitution, date of the transition to democracy, and trading blocks.

Latin American governments have traditionally been defined as “paternalistic” because of their heavy handed government intervention and protectionist policies towards workers.

Among investors, Latin-American macroeconomic stability is the main concern since the region is characterized by high debt levels, high unemployment rates, high inflation levels, poor financial flows, and the constant need for foreign aid. Table 2 summarizes the main economic trends of the five countries.

Moreover, corruption has been a governance problem for most of these Latin American countries. In 2002, The Corruption Perception Index (CPI) by Transparency International listed the region of Latin America as one of the most, if not the most, corruption-plagued regions in the world, due to tax evasion, bribery and dishonest practices that disadvantage foreign operators. In 2001-02, the International Development Bank (IDB) offered loans in support of anti-corruption and transparency initiatives to several of these countries. The IDB's Multilateral Investment Fund also approved a US \$1.23 million grant in 2001 to Argentina, Brazil, Chile, and Venezuela to track and analyze transactions suspected of being money-laundering operations.

The debt crisis of the 1980s led many Latin American countries to adopt an export-oriented development strategy, implying major reforms in their economic and governance structures. Some of the most common policies developed are the privatization of the state-owned enterprises, trade liberalization, and cuts in the social spending. As argued by Cook (1998), even though these new policies improved the economies, they produced discomfort, particularly among labor unions.

Starting in the 1990s, massive inflows of foreign capital entered Latin American countries. A symbolic number is that after the big three state-owned oil companies (Pemex in Mexico, PDVSA

in Venezuela, and Petrobras in Brazil), foreign owners dominate the list of the 50 largest firms in Latin America (Grosse, 2001:669).

In the next section, I describe the main country characteristics, stressing the predicted future trends.

Argentina

Argentina, over the past decade, has suffered recurring economic problems of inflation, external debt, capital flight, and budget deficits. During the last six years the inflation rate has been unstable, changing from - 1.1% in 2001 to 6.6% in 2006 with a peak of 25.9% in 2002 (GMID Country Profile, 2007). This fact is a consequence of the economic collapse in 2001 and 2002, although it is slowly recovering and starting to show growing trends. Although the durability of Argentina's economic recovery is fragile because it depends primarily on volatile external factors rather than longer-lasting productivity gains. For example, Argentina has doubled its percentage of trade in the last decade, exporting agricultural products and importing intermediate goods (EUI, 2004).

Another important fact for the Argentinean economy is its debt. In 2005, it was huge and complex. It involved 152 varieties of paper denominated in six currencies and governed by eight jurisdictions (GMID Country Profile, 2007).

Argentina has generally encouraged inward FDI despite a

government showing signs of interventionism in business activities. Furthermore, companies doing business in Argentina are charged one of the highest corporate tax rates in Latin America (35%) (GMID Business Environment, 2007). The total tax rate as a percentage of profits reach 116% (the highest is Latin America and one of the most punitive in the world)—the OECD level is 46.8%. That means FDI rates decreased in 2005 (\$ 4.7 billion) from 2000 (\$ 10.4 billion) (WDI, 2007). Most of the investment has been made by local companies, explaining the 50.4% total annual growth during the 2002-2006 period (GMID Business environment, 2007). Lastly, Argentina still has government-imposed capital restrictions on the movement of capital in or out of the country.

From a positive angle, the corruption perception index in 2006 (2.9) was better than in 2004 (Transparency International 2006). Although, as we summarize in Table 4, in the 2002 survey, in Argentina, 90% or more of the people responded that corruption had increased “a lot” in the last 12 months.

It is predicted that Argentina will be the best performer in 2008 in GDP growth, among the countries of Latin America because real interest rates are on a decreasing trend, which is pushing household consumption and business investment up.

Brazil

The Brazilian currency (*real*) depreciated sharply in 2001 and 2002, leading to an inflation rate in 2003 of 15%. In 2006, the inflation rate was 4.2% (Table 2) demonstrating the economy is recovering. Brazil's economy has been improving but the pace of growth is still somewhat disappointing. The public sector accounts for around 45% of GDP and is one of the main reasons why Brazil's performance does not match that of other large emerging markets (GMID Country Profile, 2007).

FDI is recovering slowly from the crisis of 2002 and it is still one of the lowest percent of GDP of Latin America, repelling additional investments from foreign companies. Complexity of labour regulations is also threat for both domestic and foreign companies, and the tax burden for a medium sized can reach 71.1% (GMID Business environment, 2007).

Another important fact is that the judicial system is dysfunctional and many of its judges are corrupt, with a 3.3% of corruption index (Transparency International, 2006).

A short-term future, tax cuts are planned for 2007 and 2008. And the private sector increased the investment between mid 2006 and 2007 (GMID Country Profile, 2007).

Chile

Chile has performed very well over the last 15 years, after

the effects of the 1999 recession. The inflation rate has declined in the last decade stabilising around 3.5% in 2006 (Table 2).

FDI in Chile as a percentage of GDP is one of the highest in Latin America, at a level of 6 % in 2005 (Table 3). This is result of an open policy toward FDI and, that Chile's companies are benefiting from the most transparent and investor friendly regulatory environment in Latin America. Chile was the leader in adopting open-market-oriented trade policies and fostering foreign direct investment in all economic sectors, including capital markets. Moreover, the Chilean government engages in a multitude of bilateral and multilateral free trade agreements with other countries—a policy that often irritates its Latin neighbors.

Although Chile is ranked as the world's most attractive destination for mining investment, the unemployment rate is still relatively high (7.8% in 2006) despite being the lowest rate in eight years (Table 8). Moreover, a level of rigidity in the labour market could increase their cost.

The public sector is generally honest and efficient. Chile is the least corrupt country in Latin America, with a perception index of corruption of 7.3% (Transparency International, 2006)—measured as transparency in the three main dimensions: citizen participation, accountability and disclosure of purchase prices and supervision of federal officials.

Venezuela

Mr. Chávez, reelected in 2006, has made it very clear that he does not intend to privatize strategic economic activities, including oil production and the transmission and generation of hydroelectric power (EIU, Venezuela, 2004). As a consequence, the political climate of Venezuela is characterized by high levels of distrust, despite being among the world's top ten crude oil producers (see Table 2).

The inflation rate has changed in the last 6 years, with a rate of 12.5% in 2001, a peak of 31.1% in 2003, and stabilising in 13.7% in 2006 (GMID Country Profile, 2007).

Venezuela joined MERCOSUR in December 2005. On the other hand, Hugo Chavez announced in 2006 the separation from CAN, creating regional tension (EIU, Venezuela, 2007).

Venezuela's government intervenes openly in the economy, creating distortions in goods, services and capital markets. As a consequence, inflows of FDI tend to stabilize because investors are concerned about the state control over the economy. Moreover, foreign participation in privatization is ruled by "special laws," requiring that between 10 and 20% of the shares of the privatized firm be reserved for the firms' current and retired workers. The government can also set aside a percentage of shares to be offered

in local capital markets (PRS, Venezuela, 2003). As a consequence of this government “interventionism,” thirteen private Venezuelan companies have issued U.S. American Depository Receipts fearing government expropriation.

Companies doing business in Venezuela find a high level of corruption that can significantly increase their costs. 2.3 is the lowest index of perception of corruption among the five countries studied in this chapter, with a score below 3 defined by Transparency International as “rampant corruption” (Transparency International, 2006). To conclude, it is important to highlight that Venezuelan GDP growth has been exceptionally high in the recent years thanks to record high oil prices.

Colombia

President Uribe, elected in 2006, has focused on economic policies and democratic security strategies that have engendered a growing sense of confidence in the economy, particularly within the business sector. Colombia is showing incontestable signs of development—although it continues to struggle with the narco-terrorism problems. FDI has been increasing as a result of the Government’s sound policies, growing at a 20% annual rate during the period 2001-2006. Colombia’s trade has increased, mostly due to oil exports (EIU, 2004). Unemployment is falling and the poverty

rate has dropped to 49%.

On the negative side of things, the deficient tax structure and high tax rates affects directly business. The rate of corporate tax is the highest in Latin America at 39%. The total tax rate for a medium sized company in Colombia is 82.8% of profits (GMID Business environment, 2007).

Mayors from Colombian regional capitals signed “transparency pacts,” which were defined as public agreements between the elected officials and their constituents to implement efficiency and anti-corruption programs (Wills and Ureña, 2003). The corruption Perception Index has remained quite constant for the last few years at 3.9 (Transparency International, 2004).

To conclude, we examine how global these five countries are, given their increase in trade. From the last two columns in Table 3, we can see that in 2006 there was great dependence on the U.S., which ranked first (or second) as an import-export partner of all five countries. Recent policy analysis and the business press foresee a much closer trade relationships between Latin America and China as the latter needs for more natural and mineral resources.

CORPORATE GOVERNANCE

The development and growth of Latin America is contingent

on developing good corporate governance practices. These countries are at different stages in their transition to effective corporate governance, and this is directly related to their political governance. In order to succeed, a country needs both effective political and corporate governance. The characteristics of the country's legal institutions, the financial system (particularly the stock market), employment system, and structure of firm ownership define much of the country's corporate governance system. We discuss each of them in turn.

Legal system

The importance that the underlying legal systems have on various corporate governance-related issues such as in the spread of codes of good governance (Aguilera and Cuervo-Cazurra, 2003) or creditor protection (Djankov, McLiesh, and Shleifer, 2004) is well established.

Law, in these five countries is based on French civil legal tradition that relies primarily on statutes and comprehensive codes (La Porta, et al., 1998). Table 5 shows that the time required to start a new business in terms of bureaucratic paperwork is fairly similar across these countries, with an average of 67 days. Chile has the lowest cost and Brazil and Venezuela the highest (Djankov, et al., 2000). According to the research by La Porta et al. (1998)

summarized in Table 5, the judicial system is also important, with the most efficiency and integrity in Chile and Colombia and the lowest in Brazil, although Colombia has a comparatively very low rule of law index, which captures the country's lack of law and order. Other key variables for corporate governance are the rating of accounting standards which reflects the transparency and disclosure of company annual reports and for which Brazil has the highest and Venezuela the lowest rating. "Anti-director rights," measuring the legal protection of minority shareholders, is the highest in Chile and the lowest in Venezuela.

Latin America is fully aware of the need to increase transparency and efficiency to their corporate governance systems in order to fully participate in the global economy. In 2001, Argentina enacted capital markets reform in a law that covers most firm-level corporate governance issues. Then, in 2002, FUNDECE and IDEA (two private sector associations) established the *Instituto Argentino para el Gobierno de las Organizaciones* (IAGO), which aims to raise awareness of good governance and to provide director training. The Brazilian Corporate Governance Institute (IBGC) launched its Code of Best Practices in 2001. Chile was the first country in Latin America to reform the legal and regulatory framework of corporate governance, including two main issues: banking regulation and the development of supervisory institutions.

Colombia's private-sector efforts in corporate governance center on *Confecamaras* (Confederation of Chambers of Commerce) and its Corporate Governance Project is responsible for improving the awareness of good governance practices throughout the private sector. Finally, AVE (Venezuelan Executive Association) sponsors corporate governance awareness in Venezuela, and in 2003, with the participation of some private-sector and public-sector entities, AVE established an Executive Council for Corporate Best Practices. In a way, these positive efforts to improve corporate governance are minority shareholders engaging in "bonding" (Coffee 1999) by committing themselves to play by international corporate governance rules.

Financial system

The banking system in Latin America is comparatively rather weak. For example, as shown in Table 6, private credit by commercial banks and other financial institutions as percentage of GDP is low (below 50%) in all five countries except Chile, which is higher. These ratios are low if we compare them with Spain (106%) or the United Kingdom (106%). In addition, the creditor index (Djankov et al., 2004), which measures four powers of secured lenders in bankruptcy, is 2 or below in four of the countries, 0 being poor creditor rights and 4 strong rights.

The comparative analysis of the banking system in the five Latin American countries shown in Table 6 also illustrates that there is concentration in the sector. There is a high incidence of foreign bank ownership, coupled with the recent decline of state-ownership that is the product of the liberalization of the sector. In contrast to these trends, only three of Brazil's top ten private banks were foreign-owned at end 2006: ABN Amro Real (Netherlands), Santander Banespa (Spain) and HSBC (UK). (EIU 2007) In Colombia the situation is similar: the two local financial groups (Sarmiento Group and Grupo Empresarial) own 59% of total assets, meanwhile the only remaining state-owned bank, Banco Agrario, accounts for merely 6%. On the contrary, Banco Santander, the first bank in Chile, accounts for 22 % of total assets at the end of 2006, a clear example of the high incidence of foreign ownership banks. Another example is Venezuela where two of the four largest universal banks—universal banks account for around 75% of total financial-sector assets—are majority Spanish-owned.

The capital markets of these countries are fairly underdeveloped, but not homogenous. The highly entrenched corporate ownership and the fact that private corporations are closed and family-owned are two characteristics influencing the

Latin American structure of capital markets (Welch, 1993).

Argentina has the oldest stock market, founded in 1854, and Venezuela the newest (1947). Chile engages in the highest market capitalization of listed companies as percentage of GDP as shown in Table 7. U.S. banks, and particularly, pension-fund managers are among the most dynamic players in Chilean capital markets. In 2001, the Brazilian stock market (BOVESPA) created three new market segments requiring different degrees of corporate governance.² The Brazilian Novo Mercado has received active support from a number of Brazilian governmental organizations, as well as from the International Finance Corporation, the World Bank, the Organization for Economic Cooperation and Development, the Private Sector Advisory Group on Corporate Governance and the Global Corporate Governance Forum (Santana, 2003). In Brazil there are about 6 000 companies with over 250 employees, only 120 of those companies are listed and regularly traded on the São Paulo Stock Exchange (BOVESPA).

² These include: a) Special Corporate Governance Level 1, which requires companies to become more transparent by disclosing information such as financial statements, insider trading and self dealing (28 listed companies); b) Special Corporate Governance Level 2, which requires companies to abide by all of the obligations set forth in the stricter regulations for the Novo Mercado with a few key exceptions; and c) Novo Mercado, inaugurated in 2002, where many private companies and future IPOs will contemplate listing, although the process has slowed down due to the stagnation of Brazilian capital markets.

The market capitalization of listed companies and total value traded in Argentina and Venezuela is at minimum levels as shown in Table 7. This is explained by the lack of investor confidence in the economic and political stability of these two countries. The largest stock markets in Latin America, according to FIBV, are Brazil and Chile. Colombia's capital market is underdeveloped, but it has improved in the last three years and the exchange-rate has been appreciation since 2003, increasing market capitalization in US\$ 42.7bn.

Employment system

Latin American labor laws are based on a paternalistic model. Historically, Latin America has been characterized by high levels of state intervention and poor civil society action. This is the main reason why labor unions have developed strong ties with political parties and, even in some cases, the country's president comes from populist labor-based parties (Argentina, Brazil and Venezuela). Similarly, union activism has been critical in resisting military regimes. Unions are active in Latin America in comparison with other developing countries and with the more industrialized world, and they tend to negotiate at the national or sectoral level. Argentina, and particularly Venezuela, have witnessed the most massive general strikes. For example, in December 2003 the CTV

and FEDECAMARAS (business organization) in Venezuela called for a national strike, and most companies answered the call. For almost two months, Venezuela's oil company (PDVSA) (one of the world's largest, and ranked number 76 in the 2004 Fortune 500 World's Largest Corporations) shut down almost 100% of its production, distribution and exportation of oil. The strike ended with strikers gaining a referendum for Presidential elections.

Unemployment rates increased dramatically in the early 2000s reaching above the 10% mark in 2002 for all countries except Chile, as shown in Table 8. At the present the rates are making satisfactory downward progress, except Chile's unemployment rate which is keeping stable. Argentina has the highest unemployment rate of all five countries, and, of course, Brazil, the largest labor force.

The common denominator in these five countries is recent labor reforms, as shown in Table 8. Murillo (2004) argues, however, that economic pressures are not the sole cause of labor reform because Argentina, Venezuela and Chile had different levels of trade liberalization, labor costs and rates of unionization prior to their labor reforms. For example, Chile had the lowest labor cost of the three, and Venezuela the highest. Argentina and Venezuela have the highest rates of unionization followed by Brazil and Chile. In spite of these differences, these countries passed reforms of

individual labor regulation in a politically uncertain climate.

All five countries have undertaken recent reforms in their labor laws, some of them also reflected in their constitutions. According to Cook (1998), three kinds of changes have occurred in Latin America's labor law. First, flexible laws deregulate labor markets and reduce employer costs. Second, liberal reforms strengthen the autonomy of the unions and employer organizations from the state as well as support pluralism; and, finally, reforms are based on the protection of the workers through national legislation rather than leaving it at the mercy of individual firms. Cook (1998) argues that Argentina has changed its labor law from protective to flexible, Brazil from liberal to flexible and then to protective, Chile from protective to liberal, and Colombia from protective to flexible. Venezuela, under Hugo Chavez, has adopted a retroactive reform. For example, in 2002, the *inamovilidad* decree (prohibiting firms from laying off employees) was enforced.

The strength and organization of the labor movement varies across countries. Argentina's labor movement is one of the strongest in Latin America. Colombia's union representation is small and fragmented due to political instability and notorious drug trafficking problems, corruption and guerrilla movements. At the beginning of Chile's democratization process, its unions were weak due to low membership, labor fragmentation and political divisions,

but through the years these factors have been changing, and the union density rate has increased.

Union density has been fairly stable in the past decade, as shown in Table 8. In 2002, the union density rates are: 28% in Argentina, 22% in Brazil, 8 % in Colombia, and 32 % in Venezuela. Chile is the only country that experienced important changes in union rates, following the reestablishment of democracy, rising from 13% in 1998 to 22% in 2002. Table 8 also enumerates the main unions in each countries and their membership.

Firm ownership structure and control

A common denominator among Latin American publicly traded firms is the high degree of ownership concentration. Families are the main owners, even among the largest companies (OECD, 2003). Often control is in the organizational form of a conglomerate or business group, defined as a group of firms that are related to each other through ownership relations and controlled by a local family, a group of investors or by a foreign company.

Apreda (2001) argues that before 1991, the largest Argentinean firms were diversified in terms of ownership; and after 1991 these companies were subject to significant economic reforms under the Menem administration and opened to foreign

investors. Yafeh and Khanna's (2000) study confirms Apreda's findings, as they show that among the 40 largest listed Argentinean companies, 25 are foreign-owned, 14 family-owned and one is state-owned, and among these 40 there are 11 conglomerates. Yafeh and Khanna (2000) studied 100 non-financial firms in Brazil and found that two have dispersed ownership, 29 are controlled by a local family group, 37 by a foreign firm and 32 by the federal government. Again, business groups are a predominant organizational form, totaling 38 business groups in these 100 firms. This is also the case in Chile, where 68% of the Chilean non-financial listed firms are controlled by one conglomerate (Lefort and Walker 2000). Another similar fact happens in Venezuela, where half of the ownership of Venezuelan SMEs is concentrated in the hands of members of the same family: "56% of the companies are integrated by an individual shareholder or a partner, only 14% have three or five partners and the remaining 30 % only have to partners" (INSOTEV industrial sector poll).

Data on Latin American firm ownership is either nonexistent or difficult to acquire. The OECD's (2003) White Paper on Corporate Governance systematically compares ownership structure of some of the countries, and we have added

additional data for the countries not included (see Table 9). In the case of Argentina, even though it is a very limited sample for 2002, 90% of ownership is in the hands of the 5 largest owners, and a majority of ownership is in the hands of the largest owner. The OECD data also confirms that in most cases the owner is foreign, followed by a private domestic owner. Table 10 shows that for the same sample, most of the firms belong to pyramidal business groups, which is a mechanism to separate ownership and control. This is also reflected in the composition of the board, which has a minority of independent directors.

Brazilian corporations are mostly family-owned, and this has effects in the type of management that prevails. According to Oman (2003), there are two main constraints in Brazil's corporate governance: (1) a high level of shareholder expropriation and, (2) the nature of its legal system. Table 9 shows that in most firms the largest shareholder has majority control and that the main type of owner is domestic (presumably family-owned). Table 10 illustrates the limited power that shareholders have, with 87% of the firms having non-voting shares as well as few independent directors on the board.

Chilean firms are controlled by a few large business groups, which are structured in pyramidal style, with one or more

investment companies as the center of control. Operating companies, which are on the top of the pyramid, usually are listed on the stock exchange and, therefore, have outsider shareholders (Oman, 2003). Ownership is slightly more dispersed and in the hands of domestic owners, as shown in Table 9. The percentage of shareholders without voting rights is low, and the governance system of the board of directors seems more in line with international standards, with a majority of independent directors (as shown in Table 10).

Data on Colombia and Venezuela is fairly limited and unreliable, as shown in Tables 9 and 10. In Colombia, the majority of firms are owned by the largest five owners, the boards are reportedly small as well as the percentage of shareholders without voting rights over those with voting rights. Finally, in 50% of a sample of Venezuelan firms, a single owner has majority ownership, and the most active firms (those that issue ADRs) are mostly domestically owned.

CONCLUSIONS

The economic recovery in Latin America started in the early 1990s with the relaxation of trade barriers, the inflow of foreign capital and massive privatizations of state enterprises (Grosse, 2001). These economies had positive growth, as shown

in Table 2, but the trajectory has been bumpy. For example, while in the 1990s, Argentina was considered among the top 10 most attractive investment locations in the world, this all changed with the economic (tequila) crisis that began in 2001 (FDI inflows fell 69% from 2001 to 2002) and provoked a severe recession, financial turmoil and political instability. Even though Argentina still remains open to foreign investment, its high corruption levels and the weakness of the judicial system makes foreign and domestic investors reluctant to invest there. Argentina had the largest external debt in 2003, which is a consequence of financial crises and currency devaluation (WDI, 2003).

Brazil, the Latin American behemoth, has an active private economy, but as in most of the region this is accompanied with serious social problems. Current President Lula Da Silva has requested the help of businesses in strengthening Brazil's social agenda and in reining in government expenditure. He expects financial contributions from state-owned companies, specially the state oil company, Petrobras—which represents two-thirds of the country's primary surplus (PRS, 2003) and is ranked 144 in the 2004 *Fortune* World's Largest Corporations. Chile is currently the most economically and politically stable country in Latin American. It was the first country in the region to liberalize its

foreign investment regulations, which is a key factor in the financial system (Treviño and Mixon, 2004) and also adopted effective banking practices which raised investor confidence. Colombia and Venezuela lag far behind in terms of modernization of their corporate governance systems and the overall economy.

Latin American countries stand out for their recurrent macroeconomic uncertainty and political instability. In terms of corporate governance, they share high ownership concentration patterns (state or family-owned), small and illiquid stock markets and limited options for corporate financing. Business leaders and politicians are increasingly aware that efficient corporate governance through transparency, greater accountability and effective protection for shareholders is necessary for economic development. Latin American countries should increase their corporate transparency requirements, strengthen their legal systems, prevent shareholder expropriation by developing effective minority shareholder protection, provide adequate access to investment resources for small and medium-sized firms as well as long-term financing to foster firm competitiveness and growth, and, finally, allow more activism from institutional investors who are likely to demand higher corporate governance standards, as they did in the U.K.

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Table 1. Political Context

	Constitution (1)	Democratic Transition (1)	Trade Blocks (1)	Population (millions) 2006 (2)
Argentina	May 1853	1983	MERCOSUR and Associate member of CAN	38.7
Brazil	October 1988	1985	MERCOSUR and Associate member of CAN	190.5
Chile	September 1980 (but last amended in 1987)	1990	Associate member of CAN and MERCOSUR	16.4
Colombia	July 1991	1958	CAN and Associate member of MERCOSUR	46.3
Venezuela, RB	December 1999	1958	MERCOSUR	27.1

Sources: (1) CIA Factbook; (2) GIMD: Global Market Information Database.
MERCOSUR: Mercado Común del Sur (Argentina, Brazil, Paraguay and Uruguay)
CAN: Comunidad Andina (Bolivia, Colombia, Ecuador, Peru and Venezuela)

Table 2. Main Economic Factors

	Inflation Rate (%) (1)	GDP Real Growth Rate (%) (1)	GDP Current (USD billions) (1)	Oil Production (bbl/day) (million) (2)	External Debt (% GDP) (3)	Internet Users (% of Population) (3)	General Government Final Consumption Expenditure (% of GDP) (1)
	2006	2006	2006	2005	2006	2006	2006
Argentina	6.6	8.5	214	0.66	61	21.14	8
Brazil	4.2	3.7	1.068	1.63	18	22.42	20
Chile	3.4	4	146	0.004	42	25	N/A
Colombia	4.3	6.8	136	0.52	40	13	8
Venezuela, RB	13.7	10.3	182	3.12	24	16	11

Sources: (1) GIMD; (2) OPEC; (3) CIA Factbook.

Table 3. International Trade and Globalization

	FDI net inflows (% of GDP) (1)		Trade (% of GDP) (1)		Main Destinations of Exports (2,3)	Main Origins of Imports (2)
	1993	2005	1993	2006	2005	2005
Argentina	1	3	16	42	Brazil 16.6%, US 11.2%, Chile 10.9%, China 8.6%	Brazil 33.8%, US 15.7%, Germany 5%, China 5.1%
Brazil	0	2	29	26	US 19.2%, Argentina 8.4%, China 5.8%, Germany 4.2%	US 17.5%, Argentina 8.5%, China 7.3%, Netherlands 0.8%
Chile	2	6	57	N/A	US 18%, Asia 32.7%, Europe 31.7%, Latin America 16.4%	Latin America 38.5%, US 18.5%, Europe 18.3%, Asia 17.5%
Colombia	2	8	35	41	US 40.4%, Venezuela 9.2%, Ecuador 5.7%, Peru 3.5%	US 28.1%, Venezuela 6.4%, Brazil 5.5%, Mexico 5.9%

Venezuela, RB	1	2	54	53	US 57.8%, Canada 2.9%, Netherlands Antilles 4.6% , Dominican Republic 2.8%	US 28.9%, Colombia 8.4% Brazil 6%, China 3.8%*
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Sources: (1) WDI; (2) EIU (2006). (3) GMID 2006

Table 4. Corruption Indicators

	Corruption Perception Index (2006) (1)	Critical Areas of Budget Transparency (% of Positive Responses) (2)			Perception of Change in the Level of Corruption (2)				Direct Experience of Corruption (%) (2)
		Citizen participation (% most critical)	Accountability (%)	Supervision of federal officials (%)	2000-Corruption increased (%)		2002-Corruption increased (%)		
					A lot	A little	A lot	A little	
Argentina	2.9	8	25	20	87	5	90	3	25
Brazil	3.3	11	24	33	85	5	78	6	61
Chile	7.3	21	39	37	60	15	58	13	13
Colombia	3.9	N/A	N/A	N/A	80	9	85	4	19
Venezuela, RB	2.3	N/A	N/A	N/A	54	11	73	7	27

Sources: (1) Transparency International (2006); (2) www.globalcorruptionreport.org

Table 5. Business Environment

	Time to start a new business (1)			Legal Environment (2)				
	Number of Procedures	Time (days)	Cost (GNP/ capita)	Efficiency of Judicial System	Rule of Law	Risk of Expropriation	Rating on Accounting Standards	Anti- Director Rights
Argentina	12	71	0.232	6	5.35	5.91	45	4
Brazil	15	67	0.673	5.75	6.32	7.62	54	3
Chile	9	78	0.116	7.25	7.02	7.50	52	5
Colombia	17	55	0.124	7.25	2.08	6.95	50	3
Venezuela, RB	15	67	0.673	6.50	6.37	6.89	40	1

Sources: (1) Djankov, La Porta, Lopez-de-Silanes, and Shleifer (2000); (2) La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998).

Table 6. Banking System

	# banks	Private Foreign	Private Domestic	Provincial Public	National Public	Private Credit /GDP (2)	Creditors Rights (2)
Argentina (1)	73	27 (37%)	32 (44%)	10 (13.5%)	4 (5.5%)	0.19	1
	# banks	Foreign-owned	State-owned			Private Credit /GDP (2)	Creditors Rights (2)
Brazil (1)	159	61 (38%)	98 (62%)			0.35	1
	# banks	Foreign-owned	Local-banks			Private Credit /GDP (2)	Creditors Rights (2)
Chile (1)	25	12 (48%)	13 (52%)			0.61	2
	Sarmiento Group (% of total assets)	Grupo Empresarial (% of total assets)	Banco Agrario (% of total assets)	Private banks: foreign and state-		Private Credit /GDP (2)	Creditors Rights (2)

				owned (% of total assets)		
Colombia (1)	35	24	6	35	0.27	0
	# banks	Private banking institutions	Public banking institutions	Private Credit /GDP (2)	Creditors Rights (2)	
Venezuela (1)	59	49 (83%)	10 (17%)	0.11	3	

Sources: (1) EUI 2006; (2) Djankov, Mc Liesh & Shleifer (2004)

Table 7. Stock Market

	Stock Exchange Foundation	Total Value Stocks Traded (% of GDP) (1)		Stocks Traded, Turnover Ratio (%) (1)		Market Capitalization of Listed Companies (% of GDP) (1)		Firms with ADRs (2)	Publicly Traded Firms (3)			
		1993	2006	1993	2006	1993	2006		1998		2003	
									Domestic	Foreign	Domestic	Foreign
Argentina	1854	4	2	33	7	19	37	9	131	0	106	4
Brazil	1890	13	24	33	43	23	67	32	534	1	389	2
Chile	1893	6	20	7	19	100	120	17	287	0	240	1
Colombia	1929	1	8	10	22	17	41	1	118	0	108	0
Venezuela, RB	1947	4	0	24	9	13	5	13	162	1	57	2

Table 8. Employment Relations

	Labor Force (millions) (1)			Unemployment Rate (%)			Labor Law Reforms	Principal Unions	Members per Union (millions)	Unionized Work Force (%) (4)		
	1998	2002	2006	1998 (1)	2002 (1)	2006 (2)				2003 (3)	2003 (3)	1993
Argentina	14.3	16	18.7	12.8	15.6	11.4	2000	CGT (General Confederation of Labor), CTA (Argentine Workers Central)	CGT=3 CTA=0.6	28	28	28
Brazil	76.6	82.7	92.7	9	10.5	10	1988	CGT (General Confederation of Workers), CUT (Central Workers Union), The Union Force	These account for more than 60% of the unionized workforce	22	22	22
Chile	5.9	6.6	6.6	7.2	8.5	7.8	2001	CUT (Central Workers Union)	CUT=0.47	13	13	22
Colombia	17.5	19.8	22.5	15	14.2	11	2002	CUT (Central Workers Union), CDTC (General Confederation of Colombian Democratic Workers), CTC (Confederation of	8% of Colombian labor force is unionized	8	8	8

								Colombian Workers)				
Venezuela, RB	9.3	8	10.7	11.2	18.4	8.8	1997 (with changes in 1999)	CTV (Confederation of Venezuelan Workers)	One fifth of workers are affiliate with some union	32	32	32

Sources: (1) WDI; (2) EIU 2006; (3) EIU (2004-2005); (4) PRS (2003)

Table 9. Corporate Governance: Ownership Dispersion and Identity

	Ownership Concentration			Owner Identity						
	Sample	% of largest shareholder	% of 3 largest shareholders	% of 5 largest shareholders	Domestic-private (%)	Foreign (%)	State (%)	Disperse ownership (%)	# of groups (1997)	% of affiliation to groups (2002)
Argentina*	15	61	82	90	38.6	59,1	2.3	0	11	93
Brazil	459	51	65	67	43	33	21	3	38	89
Chile	260	55	74	80	69	30	0.8	0	50	68
Colombia	74	44	65	73	N/A	N/A	N/A	N/A	7	50
Venezuela, RB	33	50	N/A	N/A	60*	20*	N/A	20*	N/A	N/A

Source: OECD (2003). (*) Data from 20-F ADR filings.

Table 10. Corporate Governance: Control and Board Structure

	Separation of Ownership and Control				Board Structure		
	% of firms with non-voting shares	Non-voting/voting shares	% of firms in pyramids	% cash flow rights of controller	# of board member	% of independent members	Board member / board seats
Argentina	3.9	0.14	93	68	8.10	38.8	1.2
Brazil	86.9	1.29	89	60	8.5	28.6	1.1
Chile	7.2	0.07	68	57	7.6	55	1.6
Colombia	7.1	0.09	50	N/A	5	50	N/A
Venezuela, RB	N/A	N/A	N/A	N/A	8.3*	36.6*	N/A

Source: OECD (2003); *Venezuela's board structure data is from a sample of 10 companies.

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