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**CORPORATE GOVERNANCE IN CHILE**

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## **CORPORATE GOVERNANCE IN CHILE**

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### **Resumen**

El objetivo de este artículo es describir las principales características del régimen de gobierno corporativo en Chile en los noventa y evaluar su funcionamiento. Según la literatura existente, el sistema chileno puede ser descrito como “interno”. Las sociedades anónimas abiertas están generalmente controladas por grandes grupos, organizados a su vez en forma piramidal. A pesar de esto, el sistema tiene un nivel de discriminación moderado contra pequeños accionistas u otras partes interesadas, como los tenedores de bonos. Esto debido al monitoreo ejercido por algunas instituciones financieras, como las AFP, la legislación bancaria y de seguros, y por el organismo regulador. Sin embargo, desde la crisis financiera mundial de 1997-98, el mercado de capitales chileno ha mostrado un cierto abatimiento. Además de la salida de capitales desde la región, otras causas son la compra de grandes compañías chilenas por multinacionales y algunos casos de extracción de rentas a minoritarios. En un intento por impulsar el mercado, algunos vicios en prácticas corporativas fueron corregidos (parcialmente) por la entrada en vigencia de la “Ley de OPA” en diciembre del 2000. Esta ley busca reforzar la protección a los derechos de los accionistas minoritarios. La experiencia chilena muestra la importancia de factores generalmente no considerados en la discusión sobre gobiernos corporativos en países en desarrollo, como inversionistas institucionales regulados y la legislación bancaria.

### **Abstract**

The purpose of this paper is to describe the main features of the Chilean corporate governance regime during the '90s and to evaluate how well it runs. According to the existing literature, Chile's system can best be described as an “insider” one. Large groups organized in a pyramidal fashion typically control publicly traded companies. In spite of this, corporate governance discriminates moderately against small shareholders or outsiders (e.g. bondholders). Some of the reasons behind this are the monitoring role of some financial institutions, such as AFPs (pension fund managers), the insurance and banking regulation, and an active supervisory agency. However, since the onset of the 1997-98 world financial crisis, Chilean capital markets have been gloomy. Capital outflows from the region have not been the only cause, but also a number of large takeovers of domestic corporations by multinationals and some well publicized cases of rent extraction from minority parties are to blame. In an attempt to revive a flagging market, some vices in corporate practices have been corrected (partially) by the enacting of the so-called “Ley de OPA” (PTO law) in December 2000. This law is aimed at protecting of minority shareholders' rights. The Chilean experience illustrates the importance of factors not usually considered in discussions on corporate governance for developing countries, such as regulated institutional investors and banking sector legislation.

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## Introduction

A good point of departure for the analysis of corporate governance in Chile, or for that matter, in any other "emerging" economy is the question of why the issue of corporate governance is important in developing countries. Corporate governance is central to the operation of capital markets, which in turn is fundamental in determining the extent to which firms can rely on external sources of finance for investment. All capital markets suffer from problems of asymmetric information, which lead to market failure. However, in highly developed capital markets (e.g., those of the United States), firms have a variety of alternatives for financing investments (issue of shares, bonds, bank credit) which are often absent in developing countries.

Chilean capital markets are typical of those that can be found in middle income countries: a small and largely illiquid stock market, an embryonic bond market, and a banking sector that lends mostly short term. A large proportion of investment, even by large corporations, is financed with retained earnings or lending from other corporate members of the group to which they belong.

However, a specific feature of Chilean capital markets not found elsewhere in emerging markets is the existence of well-developed institutional investors. These are the private pension managers that arose from the pension reform of 1981. The reform replaced a pay-as-you-go system run by the state which had defined benefits by an individual-capitalization system with defined contributions and run by heavily regulated private firms (the Administradoras de Fondos de Pensiones, AFPs). All Chilean workers are obligated to choose an AFP, to which they must contribute 10 per cent of their monthly incomes (plus an administration fee). At retirement, they can opt between a lump sum that must be converted into an annuity and a programme of monthly withdrawals.

The AFPs now manage assets that are worth about one half of the country's GDP. In spite of the limitations imposed upon the AFPs in the kinds of investments they can make (to be discussed in some detail below), they have been responsible for a significant deepening of the stock market.

The Chilean corporate governance system is of the "insider" variety. In Chile, as in Continental Europe, corporate ownership is highly concentrated, the main owner being often a group with interests in a large number of companies and in several sectors of the economy. In these circumstances, a conflict arises between the controllers (or "blockholders") and non-group shareholders. Indeed, there have been highly publicised attempts at rent extraction on the part of blockholders, which have shown that such actions are possible and that company controllers have the incentives to engage in them. This may be acting to discourage potential small shareholders from entering the market.

Another important institutional feature of the Chilean corporate scene which may account for its relatively high corporate governance standards, in spite of the potential conflicts of interest noted in the above paragraph, is a highly developed regulatory framework for banks and other financial institutions. As in many other developing countries, the largest economic groups own banks, which can potentially be used by the groups' controllers to further their own interest, to the detriment of those of other shareholders – of the banks themselves or of other firms belonging to the groups. Since 1983, however, such practices have been severely limited by an evolving system of prudential banking regulations.

This paper has nine sections. Section I addresses recent history relevant to an understanding of the Chilean corporate sector today, which is described in section II. Section III presents the legal framework regulating the activities of Chilean publicly traded corporations, including a new law enacted in 2000 to protect the rights of minority shareholders. Section IV addressed the current and prospective roles of AFPs in capital markets and in improving corporate governance. In section V we describe two recent cases of attempted rent extraction by corporate controllers and the positive role that AFPs have played in blocking such actions. In section VI we present evidence with regard to the size of the control premium in the Chilean stock market. Section VII describes what has happened in the Chilean stock market since the entry into force of the corporate governance law of 2000. One of the key issues for corporate governance in developing country settings relates to banking regulation. This subject, with an illustration from Chile's recent past is addressed in

section VIII. Section IX assesses the extent to which the Chilean capital market does a good job in intermediating resources between savers and investors. Section X concludes.

## **I. Some history**

At present, for good or for ill, the government has no industrial policy and does not use the allocation of finance – through, say, development banks – to influence the allocation of investment.

But it was not always so. Beginning in the late 1930s and until the military coup of 1973, the government was very active in setting up firms and opening up new sectors of economic activity that required large investments that the private sector was unable or unwilling to undertake. Contrary to conventional wisdom, the Chilean state was very successful as an entrepreneur and set up large companies – mostly fairly well run – in sectors such as power generation and distribution, petroleum extraction and refining, steel, and sugar refining.

The Frei Montalva Government of 1964-70 carried out a successful negotiation with the United States owners of Chile's copper companies (Kennecott and Ananconda) and purchased for the Chilean state 51 per cent of their equity. The remaining 49 per cent was expropriated during the Allende Government (1970-73), which also expropriated most of the country's industrial firms, banks, and insurance companies.

The first wave of privatizations came in 1974-79, when most of the firms taken over by the government during the Allende period (significantly, excluding Codelco, the company set up to run the copper mines), were sold off to new private owners, often different ones than those who had been expropriated. Powerful new groups emerged, often with a bank at their core. These groups proceeded to buy up other companies with loans from their main bank. Most of these groups went into bankruptcy during the debt crisis. The government wound up taking over a large chunk of the banking sector and, with it, the bankrupt companies whose shares were held as collateral by the banks. This is what Carlos Díaz Alejandro (1985) has aptly called "the Chilean road to socialism".

The second wave of privatization came in 1985-89, when the banks and industrial concerns were once again sold off to private interests. In addition, many of the companies that had been in the public sector well before the Allende Government (for instance, steel, electricity generation and distribution, sugar, telecommunications, and the national airline) were also sold off. The purchasers were either foreign companies (telecommunications and the national airline) or the managers of the state-owned firms themselves. In some cases, the AFPs took up part of the equity, and a certain portion was sold at low prices to the firms' employees. A scheme by which a certain portion of the purchase price was made tax deductible was also set up to encourage small shareholders ("*capitalismo popular*").

## **II. The Chilean corporate sector today**

A good part of the current corporate landscape in Chile emerged in this fashion. The other important participants are family-owned firms, which started mostly in one sector and evolved into powerful and diversified economic groups. These have also experienced important changes over time. Many of the groups that had been formed during the period of import substitution (in textiles, for example) disappeared with the radical trade liberalization carried out during 1974-79. Others adapted to the changes in relative profitability between sectors and gradually switched out of declining manufacturing industries and into natural resource processing sectors.

Most Chilean corporations, be they of family or state origin, share a high concentration of ownership. They are managed by a "group", which owns a high proportion of their capital. These groups function as investment firms or holdings; they have a large number of firms under their control and minority stakes in many others.

These groups are very powerful and, while they concentrate their activities in a single industry, they have important interests throughout the economy. At the beginning of the nineties, assets controlled by the five largest groups accounted for 30 per cent of the market capitalization of the Santiago stock exchange (see table 1). Together, they had interests in 301 companies. On average, their investments in their main industry accounted for over 50 per cent of their equity.<sup>1</sup>

[Insert table 1]

On the basis of consolidating balance sheets for all publicly traded affiliates, Lefort and Walker (2000) calculate even higher degrees of concentration. According to their figures, in 1998 the largest group controlled 23 per cent of the total assets of all publicly traded corporations, up from 14 per cent in 1994; and the five largest controlled 54 per cent of market capitalization (as compared with 51 per cent in 1994).

The number of directors controlled by the five largest groups (as a share of the total number of directors in affiliated companies) fluctuates between 76 and 95 per cent. These figures are much higher than the share of equity owned by controlling parties in the Chilean conglomerates, which is only 57 per cent for all conglomerates and 56 per cent for the five largest (Lefort and Walker, 2000).

Chilean groups function mainly as pyramidal structures. Sometimes there exist several layers of investment companies before one gets to the level of operating firms. The latter may also control several individual companies, sometimes in unrelated sectors of the economy. Groups often enter into joint ventures with multinational enterprises (MNEs) in order to develop specific projects. Operating companies, and sometimes second or third layer investment companies are listed in the stock exchange and, therefore, have outsider shareholders. A typical structure of a large group is presented in stylized form in figure 1.

[Insert figure 1]

Groups seek control basically through pyramidal structures, mainly because cross shareholdings – a technique widely used in other countries, particularly in Asia – is prohibited by Chilean law. Another instrument to obtain greater control over a company than the degree of ownership a group has over its cash flow is the issuance of different classes of shares. While permitted by Chilean law, if approved by 75 per cent of votes at a shareholders' meeting, it is not a widespread practice. From a sample of 281 public firms in December 1999, only 21 had dual-class shares (Lefort and Walker, 2000). However, in one celebrated case, the issue of different classes of shares was an essential feature in an attempt to expropriate minority shareholders (see below the Chispas case).

Lefort and Walker (2000), on the basis of consolidated balance sheets for conglomerates, come to the conclusion that Chilean controllers have a much larger share of equity (over 50 per cent) than what is necessary to exercise control. Clearly, cash flow is also valued (and is significant). In this way, they hypothesise that conglomerate size and the share of equity ownership are positively associated with holding options on new ventures in a changing environment, while fending off competitors. According to this conclusion, connections to the authorities and access to domestic and international finance are all positively related to size and, probably, also to the ownership of equity.

A simpler explanation is that the underdeveloped nature of Chile's bond market and the shallowness of its stock market make it difficult for controllers to raise non-equity capital or shed part of their equity without considerable loss. The value that they apparently attach to cash flow could be another aspect of the same problem. Since raising investment funds in financial markets is difficult and normally expensive, it is good to hold on to cash reserves.

We collected data for the largest 177 firms listed in the stock exchange (282 in 1999). Of these, 149 had stock-owning relationships with other companies, some included in the sample, some not. The information was taken from the September 1999 FECU form of the Superintendencia de Valores y Seguros (SVS), the

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<sup>1</sup> Information as of end-1994 (Majluf et al., 1998).

government entity in charge of capital market regulation.<sup>2</sup> This form has information on current operations, balance sheets, ownership structures, and sources and uses of funds.

Table 2 shows some basic information for these 177 firms grouped by economic sector. The first and most important thing to emerge from these tabulations is the very high degree of concentration of ownership in the Chilean corporate sector, comparable to that of Continental Europe. Almost three quarters of the average company's shares are owned by the three largest shareholders, and almost 90 per cent by the largest 10 shareholders. These very high levels of concentration do not differ much by sector of economic activity. However, in the construction and finance sectors the participation of the largest three shareholders is somewhat lower than the average, a difference which disappears when one considers the largest 10 shareholders. Among minority shareholders, one finds the AFPs, ADR holders, domestic and foreign mutual funds, and individuals.

[Insert table 2]

Another interesting feature of Chilean corporate balance sheets is that debt-equity ratios are extremely low (surpassing 100 per cent only in two sectors) by the standards of other developing countries (e.g., in the Republic of Korea, where they reached levels of over 300 per cent on average before the 1997 crisis) or even of some developed countries (e.g., Japan).

This is, in itself, quite surprising, since, in "insider" systems, managers will prefer to finance projects with debt rather than with new share issues, which dilute their ownership and control. Agency theory also tells us that bond markets prefer to lend to companies with highly concentrated ownership, since the agency problem between owners and managers tends to be much less intense in such companies than in those with widely dispersed ownership patterns.

The cause for such low levels of indebtedness in Chilean companies is partly related to the undeveloped nature of Chilean capital market. Though some large Chilean companies issue bonds domestically, the organised bond market is extremely shallow, with very few daily transactions. The big purchasers of bonds are the AFPs and insurance companies, which tend to hold them to maturity. AFPs are restricted to a maximum of 20 per cent of any single bond offering. Since there are only eight AFPs, the same AFPs appear as purchasers of practically all new bond issues. The only two sectors in which bonds represent a high percentage of their liabilities are electrical companies and telecommunications, and a good share of their bonds are issued in international markets.

In our sample of 177 corporations, only 30 issue bonds at all. For only 15 corporations does the share of bonds exceed 25 per cent of total liabilities. These companies include Embotelladora Andina (soft drinks), Gener (electricity generation), Endesa (electricity generation), Metrogas (gas distribution), Embotelladora Arica (soft drinks), Celulosa Arauco (pulp and paper), and Telefónica del Sur (telecommunications). Several of these companies are the main Chilean bond issuers on international markets.

The Chilean corporate sector may not have relied heavily on the issue of debt in recent years for yet another reason, related to the finding by Lefort and Walker (2000) that controllers own more equity than is necessary for control. As we shall see below in section IX, during the 1990s firms raised substantial amounts of capital through the issue of new shares, a development that could be understood as an effort by controllers to reduce their "excessive" participation in ownership.

Banks are the main source of corporate debt. Since banks rarely lend for investment purposes, this limits the extent to which corporations can use debt financing. As the concentration of ownership increases (measured by the share of the three largest shareholders), the debt-equity ratio does rise. This provides weak evidence that more concentrated firms tend to rely more on debt than on the issue of equity. However, what rises most is debt with related parties. As the degree of concentration rises, the proportion of bank debt in total debt remains unchanged, and the proportion of bonds in fact declines.

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<sup>2</sup> This form contains standardized information for all open corporations, which must report to the SVS on a quarterly basis.

An important clue to the operation of Chilean capital markets is the heavy reliance on intra group debt. Such debt represents on average over 20 per cent of the liabilities of the Chilean corporate sector. Besides companies that have access to international bond markets, Chilean corporations tend to finance their investments with retained earnings and transfers of funds between member companies of the same group. In heavily-indebted companies (with a debt equity ratio higher than 100 per cent), intra group debt is also the highest. Thus, these figures provide some evidence that an important rationale for the existence of groups is to internalize imperfect and incomplete capital markets.

This is also in evidence when we look at data on sources and uses of funds in the Chilean corporate sector (table 3). In 1994, almost two thirds of funds came from own resources. Of this total, one half was from retained profits and depreciation accounts. At the same time, over 37 per cent of funds were used to make financial investments, which undoubtedly were, to a large extent, in firms of the same group.

[Insert table 3]

Macroeconomic evidence supports the contention that business saving (retained earnings plus depreciation funds) is the main source for financing investment. In a study spanning the period 1940-96, Agosin (2001) found econometric evidence that private investment and business saving are jointly determined. In another study using company data for 1985-94, gross corporate saving was found to be a significant determinant of corporate investment (Agosin, Crespi, and Letelier, 1999).

### **III. The legal framework**

The observation that the property structure of Chilean corporations is highly concentrated implies that we are in the presence of an "insider" system in which the main problem of corporate governance is the possibility that majority shareholders (or blockholders) may be in a position to extract rents from minority shareholders. When there is a serious conflict between non-group shareholders and blockholders, the only recourse left to the former is the sale of their shares. However, the high concentration of ownership and the shallowness of the Chilean stock market can render the exit solution very costly. This, in itself, tends to render the stock market illiquid.

The literature on corporate governance distinguishes between four "families" of corporate legislation: those of English, French, German, and Scandinavian origin. Countries with English legislation are the ones that afford the highest protection to shareholders. As a result, they have tended to evolve "outsider" corporate ownership structures with relatively low degrees of concentration. The French system is the one with the lowest degree of shareholder protection, with the German and Scandinavian systems falling somewhere in between (see La Porta et al., 1998). Countries with the latter three systems tend to have "insider" corporate ownership structures exhibiting high degrees of property concentration.

Like the rest of the Latin American countries, the Chilean legal system has a French origin, but it shows a surprising degree of investor protection, which has evolved in recent years partly through the pressure of institutional investors.

The kinds of variables that determine the extent to which the system of corporate governance protects outsider (and, especially, minority) interests, and which are characteristic of the English system include the following:

- (1) the one share-one vote principle,
- (2) proxy vote by mail allowed,
- (3) shares not blocked before a shareholders' meeting,
- (4) cumulative voting with proportional representation,



- (4) oppressed minority rights<sup>3</sup>,
- (5) preemptive rights to new share issues that can be waived only in writing, and
- (6) low percentage of share capital needed to call an extraordinary shareholders' meeting.

In Chile, the principle of one share-one vote is protected by law. However, as already noted, it can be evaded through the issue of different classes of shares.<sup>4</sup> Proxy votes by mail are not allowed. Not being able to vote by mail makes it more costly for small shareholders to exercise their rights. In addition, before a new law on corporate governance was passed by Congress in October 2000, the rights of ADR holders were vested on and exercised by the President of the Board of Directors. Since several large Chilean corporations have been issuing new shares on the New York Stock Exchange for a decade, this provision resulted in even greater concentration of power in the hands of controllers and reduced the incentive of foreign investors to hold Chilean shares through the ADR modality.

All shares that are registered five days before a shareholders' meeting may vote on the principle of one share-one vote, with the exceptions noted above. Five per cent of share capital is required to call an extraordinary shareholders' meeting. This percentage is on the low side, in comparison with international experience, and, therefore, would seem favourable to the protection of shareholders' rights. Corporate law contains oppressed minority provisions. As we shall see, they were exercised recently in a landmark case.

There exist other provisions in current legislation which weaken the access to information on the part of all shareholders. The law authorizes the management of a firm to declare certain information as "reserved" if an action is still under negotiation and making such information public could be prejudicial to the interest of the company. For information to be declared "reserved" it must be approved by at least 75 per cent of the votes of the Board of Directors. Such information must be communicated to the SVS, under confidentiality, the day after the vote. This provision could allow a company's controllers to hide information from minority shareholders and from the public, in order to use it for their own benefit.

Finally, until the approval of the recent law, PTOs could be made to some shareholders, to the exclusion of others. The old legislation established a vague duty to inform the public of a party's intention to make a tender offer. It was silent on subjects such as the minimum information that must be made available, the scope of the tender, the principle of non-discrimination, the right to revoke the acceptance of the tender, and the role of directors and managers during a tender. The main problem to which this legal vacuum gave rise was discrimination against small shareholders and holders of ADRs, who could be excluded from tender offers and later had to face much lower prices for their shares.

The new law (called popularly the "PTO law" but encompassing a much broader spectrum of corporate governance issues), which went into effect on December 20, 2000, attempts to regulate corporate governance in two main fields: prices for the sale of a company's shares during a PTO and rent extraction from controllers.

One of the key objectives of the law is to generate a higher level of efficiency in contracts, in order to minimize the manager-shareholder agency problem. The law sets up auditing committees and requires that the majority of their members be independent directors. It gives these committees ample powers of oversight over corporate activities. Its main duties are: examining financial results, proposing to the Board external auditors or risk evaluators, monitoring managerial wages and other rewards, and others activities dealt with by extraordinary shareholders' meetings. In addition, it also regulates dealings between related parties (as in the Terra case, described in section V) in order to ensure that controllers do not extract rents from non-controlling shareholders. In such transactions, when the Board of Directors cannot reach agreement, it must designate

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<sup>3</sup> These include the right to challenge the directors' decisions in court, or the right to force the company to repurchase shares of the minority shareholders who object to certain fundamental decisions of the management or of shareholders, such as mergers or asset sales.

<sup>4</sup> Whether the existence of different classes of shares with differing voting rights has an economic rationale is not at issue. Here we are interested in the possibility that it gives controllers for extracting rents from non-group shareholders and the adverse impact that this may have on the liquidity of the stock market.

independent evaluators. Moreover, shareholders representing at least 5 per cent of outstanding shares may request an extraordinary shareholders' meeting to resolve such matters, which require the consent of two thirds of shareholders.

Another reform in this direction is the granting of full rights to ADR holders. Finally, shareholders are granted withdrawal rights if the controller acquires more than two thirds of the shares outstanding or if more than 50 per cent of a company's total assets are sold or collateralized.

The principal means to ensure that minority shareholders have full rights is requiring PTOs to be made to all shareholders for sales of a large or controlling percentage of a company's shares. One of the purposes of the law was precisely to introduce this requirement. As a sop to current controllers, it gives corporations a three-year opt-out from the tender-offer provisions of the law, if approved by a majority vote at an extraordinary shareholders' meeting. An opt-out may make minority shareholders exit the firm, leading to a further shrinkage in liquidity and greater concentration of ownership. However, these are likely to be transitional problems, since in a maximum period of three years the tender offer provisions will apply to all publicly-owned corporations.

#### **IV. The role of the AFPs**

The AFPs are legally authorized to invest in corporate shares. As already mentioned, they have been responsible for a substantial deepening of the stock market. However, current legislation limits AFPs to the role of minority shareholders. Before a reform introduced in mid-2002, which affected investment limits, the AFPs were allowed to invest only up to 37 per cent of their portfolios in shares and were limited to a maximum of 7 per cent of an issuer's equity. This maximum declines if the issuer is related to the AFP, if its shares are illiquid, if its property is highly concentrated, or if it is classified as being too risky by independent risk classification firms. The law also prohibits different AFPs from colluding or constituting formal voting blocks.

The rationale for these limits is to protect contributing workers, who are the ultimate owners of AFP funds. Thus AFPs are required to invest in safe vehicles and to diversify their portfolios in order to prevent undue risk exposure. In order to prevent AFPs from extracting rents from the companies in which they invest, the law also forbids them from becoming controllers of corporations and severely limits their individual share in a company's capital. However reasonable they may sound, these provisions inhibit the AFPs from being stronger monitors of the corporations in which they invest. Not only are they relegated to the status of minority shareholders with reduced influence on the actions of corporations. They are also limited to investing a relatively small share of their portfolios in equities.<sup>5</sup> Given their significant financial power, they could play a more important role in corporate governance. This would require, of course, strong regulation in order to avoid the problems identified in the current legislation. AFPs could also play a more important role as intermediaries between savers (the working public at large) and innovative investors. Unfortunately, regulation prevents them from doing so at present. AFPs face legal limitations in the bond market. They can subscribe a maximum of 20 per cent of any new bond issue, and only through open purchases on the stock market. They are not allowed to invest in below-investment grade bonds.<sup>6</sup> This eliminates any possibility that they may provide bond finance to new and potentially high-risk companies or investments. They are also barred from participating in venture capital investments.

The recent reform created five funds among which contributors may choose. The funds differ in the degree of implicit risk associated with their portfolios. Contributors may now choose the fund that best suits their financial needs and appetite for risk.

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<sup>5</sup> They invest most of their funds in Central Bank paper and other fixed income assets. Since 1992, they have been allowed to invest an increasing share of their portfolios abroad (now up to 20 per cent), but the kinds of foreign instruments they can purchase is strictly controlled. The recent change in regulations also raised somewhat these limits.

<sup>6</sup> It should be noted that all bonds (and stocks) undergo a process of classification by independent risk evaluating companies, according to strict criteria established by the SVS. AFPs can invest only in stocks and bonds that have obtained a minimum risk classification.

With regard to corporate governance issues, the new regulations establish higher ownership limits for the riskier funds. The overall ownership limits, therefore, now depend on the decisions of contributors with respect to where they want their funds invested. Higher flexibility implies larger incentives for AFPs to monitor controllers and to structure their portfolios so as to yield higher profitability and bear greater risk.

## **V. Two cases of attempted rent extraction**

Rent extraction has been relatively infrequent in recent Chilean corporate history. As discussed below, this may be due to stringent banking regulation, which prohibits bank loans to group-related firms, provisions which are now strictly enforced. The infrequency of rent extraction may also be due to a very active and efficient securities regulation agency (the SVS), which has stringent corporate reporting requirements that render the operations of corporations quite transparent. In recent years, the AFPs have been a positive force in defending the interests of non-controlling shareholders. In one case, they succeeded in overturning a PTO on very unfavourable terms for non-controllers. In another, ongoing case, they are suing controllers for alleged losses from the sale of assets to another firm in which the controlling interest has a high stake.

### **A. The Chispas case**

In 1997, Enersis, the largest Chilean holding operating in the electrical utility sector was sold to Endesa España, a Spanish MNE in the same sector, under highly irregular conditions that bestowed inordinate benefits on Enersis' controllers and which was eventually turned back by the Chilean courts.

Enersis has a public origin: Chilectra Metropolitana, which was privatized in the late 1980s. Workers and managers were allowed to purchase shares in the company. The former manager of the company became its controller. After a restructuring, the company's name was changed to Enersis, and it became a holding company for a large number of investments. Enersis itself was controlled by a series of investment companies whose owners were its former employees. Through these companies, the so-called Chispas, the employees came to control up to 32 per cent of Enersis. The conglomerate acquired control of Chile's main electricity generating company, Endesa Chile. This purchase and various other acquisitions allowed Enersis to multiply its value 50 times, becoming one of the most important conglomerates in Latin America, with business interests in Chile, Argentina, Peru, Brazil, and Colombia.

At the moment of the tender offer by Endesa España, the old employees of the state-owned originator of Enersis were not the only owners of the Chispas. Several AFPs had important interests in one of the Chispas, Sociedad de Inversión Luz.

In spite of the large amount of funds invested by the AFPs in Enersis, their power within the firm was minimal. The reason was that, in each Chispa, there were two classes of shares, A and B. Class A shares, while having the right to higher dividends, had no voting rights. Enersis was really controlled by Class B shareholders, who owned 0.06 per cent of the company. The old manager of the state-owned company was a major owner of Class B shares.

Endesa España negotiated directly with the controllers of Enersis and made a PTO for Class A and B shares, but offered to pay a price 840 times higher for Class B shares (CLP 220 for Class A shares and CLP 185,000 for Class B shares).<sup>7</sup> In addition, Endesa España gave Class B shareholders the option of buying at a preferential price up to 5 per cent of its own shares and assured them that they would be retained as managers of Enersis for a period of at least 5 years.

The small individual shareholders (mostly former employees) were quite happy with the deal, since they had seen the share price of Enersis multiply several times in just ten years. However, the AFPs had better information and attempted to abort the operation, because they considered that the benefits from the tender

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<sup>7</sup> The average exchange rate in 1997 was US\$ 1 = CLP 419.31.

offer were very unevenly distributed. In addition, they argued that there were incentives for oppressive actions against minority shareholders that decided not to accept the tender offer for Class A shares.

They succeeded in voiding the tender offer. In 1999 Endesa España eventually succeeded in buying Enersis and its subsidiary Endesa Chile, but the former controllers of Enersis had been legally forced out of the picture.

Some authors (see Raineri, 1999) argue that the value to Enersis of Class B shareholders was large enough to warrant the special treatment afforded to them in the investment companies' ownership structure. In this view, the premium that Endesa España was willing to pay for the Chispas' Class B shares represented a kind of reward for the real value of those shares. The controllers had been able to increase the value of Enersis several times over, with Class A shareholders also benefiting. Whether the prospect of making the kinds of profits that Class B shareholders would have reaped, had the deal gone through, was necessary to induce them to exercise their considerable financial abilities on behalf of all shareholders is something we will never know.

## **B. The Terra case**

In the late 1980s, Telefónica España (another Spanish MNE) bought a controlling stake in the Chilean telephone company, CTC. A recently created subsidiary of CTC, Telefónica.net is a thriving Internet company. In 1999, Telefónica.net was sold by Telefónica Chile (the name to which CTC was changed in 1998) to the Spanish subsidiary of Telefónica España, Terra Network, for a price of less than US\$ 60 million. The alleged reason for the sale was the policy of Telefónica España of concentrate all of its Internet investments in its Madrid subsidiary.

Once again, the eight AFPs, which together owned 18 per cent of Telefónica Chile, objected, on the grounds that Telefónica.net was worth US\$ 201.7 million, according to two studies that they had commissioned. Some observers considered that figure to be very conservative. Templeton, a foreign mutual fund that had stakes in Telefónica Chile, also objected to the sale.

After several months, Templeton decided not to file suit, mainly because the costs of doing so exceeded the expected benefits. In early June 2000, the eight AFPs decided to sue the nine directors of Telefónica Chile who had voted in favour of the sale of Telefónica.net. They alleged, that, on the basis of their studies, they had lost US\$ 28.7 million (18 per cent of the difference between the sale price and their valuation of the company).<sup>8</sup>

The AFPs contend that the controller of Telefónica Chile, Telefónica España, is illegitimately extracting rents from them by selling assets at a lower price than their market value to another company in which it has a higher stake. Thus the loss in Chile is more than compensated by the gain in Spain.

This conflict, which has not yet been resolved, shows that certain actions by controllers can be detrimental to minority shareholders. It also shows that the law does provide for redress and that AFPs have the incentive and the financial clout to defend the interests of non-controllers in the courts.

## **VI. Is there a "control premium" in the Chilean corporate sector?**

If indeed the control of a corporation has a value for those who obtain it, one would expect to find a "control premium" in the price paid in PTOs. The control premium can be calculated as the excess in the share price paid in a tender offer over the price observed before the tender offer was made public. In a sample of 23 observations, the range of the estimated control premium was between 0 and 234 per cent, with an average of 33 per cent.

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<sup>8</sup> Information from the Chilean financial press. See *El Diario*, 6 June 2000.

Clearly, prospective controllers are willing to pay a premium for obtaining control. The control premium in Chile has a high dispersion around its average, which suggests that there are many variables that affect it, some of which are undoubtedly sector-specific.

The control premium can also be calculated as the excess in the price of shares with voting power over those without voting power, adjusted for differences in dividends. With this methodology, the average control premia estimated for Italy and Israel (82 and 45.5 per cent, respectively) are higher than the estimate for Chile (studies reported in OECD, 1999, p. 36). In this light, Chile's average control premium does not appear to be exceptionally high.

## **VII. What have happened after the PTO's law application?**

The best way to protect oneself from being eaten by another fish is just being the largest one. In the same way, in an aggressive-with-minorities environment, the strategy used by Chilean groups to avoid being subjected to rent extractions is wielding a strong control. Since conditions have changed after the entering into force of the PTO law in December 2000, several phenomena have occurred that are interesting to point out.

Just before the law came into force, several controllers made tender offers with the objective of taking their companies private. Some examples are Chilectra (owner of the principal electrical distribution network) and Laboratorio Chile (one of the biggest pharmaceutical manufacturers). Although it is difficult to offer firm evidence, it seems that these groups introduced noise into market with the intention of lowering the share price and being able to purchase the company at a lower cost. Minority shareholders were induced to sell their shares because, after the PTO, they would become highly illiquid. In addition, of about 270 companies registered as open societies in the Bolsa de Comercio de Santiago, 92 decided to apply the "transitory article" before the end of its applicability, by which they were able to postpone the full applicability of the PTO law for a period of three years. This, in effect, was tantamount to an announcement of an aggressive-with-minorities policy, leading to sales of the stock and a fall in its price.

However, this hypothesis is not easily proven. There is no evidence that the average share price of the companies applying the transitory article performed worse than the overall index. Other factors may be behind this apparent paradox. For instance, agents may punish the whole stock market, owing to the uncertainty of what and when firms could decide to apply the article; other firm-specific news, such as new projects announced by controllers, may have also affected prices in a positive direction, even in spite of the prospect of a company resorting to the three-year opt-out.

Despite the fact that one of the objectives of the PTO law was to deepen the Chilean stock market, more than two years into the application of the law, this has not happened. The volume traded per day in the Bolsa de Comercio de Santiago has not significantly increased. Nor have there been new initial public offerings or issues of new shares, either in the local market or ADRs abroad. One possible explanation commonly accepted by market operators is more related to economic conditions than to the functioning of the PTO law. Since 1998, Chilean economic growth has slowed sharply, and interest rates have declined to historic lows, allowing firms to resort to bank lending rather than equity issues.

## **VIII. The importance of banking supervision**

There have been important improvements in corporate governance since the debt crisis of the 1980s. The improvements have been due partially to the adoption of banking supervision practices that limit the power of controllers to misuse bank lending for their own benefit and to the detriment of non-controlling shareholders, depositors, and tax payers. The Chilean story shows that, in developing country settings, there are enormous synergies between improved corporate governance and improved banking supervision.

The liberalization of the financial system during the period 1974-81 was undertaken without the strengthening of banking and securities market supervision. The corporate law in force in those days allowed

economic groups to own banks and other financial institutions. Even though there were some limits on dealings between banks and firms belonging to the same group, these were poorly enforced. Groups also got around these limits using other financial intermediaries, such as mutual funds.

The groups that were formed during that period acquired banks, which were used to purchase yet other corporations. The groups acquired firms with resources lent to them by their bank and other financial institutions, using as collateral the assets of yet other firms that had been previously acquired. Several of these banks had access to international syndicated loans at low interest rates. Besides the enhanced commercial risks that the groups were taking on with each new purchase, they also were incurring in ever-increasing exchange rate risk, since loans were indexed to the exchange rate and the assets purchased were in pesos. Moreover, borrowing firms themselves were often in the non-traded sector (construction of malls and luxury apartment buildings) and did not earn foreign exchange. Banks themselves developed severe currency and term mismatches between their assets and liabilities. Banks lent without a proper evaluation of credit, since a large proportion of loans were to related parties. A fixed exchange rate, announced by the government to be "forever", fostered the illusion that there was no currency risk.

These financial dealings by the main groups of the day clearly represented a serious problem of corporate governance, aided and abetted by weak financial market regulations. It was thought at the time that financial markets, and especially banks, were capable of self-regulation. Thus groups were able to lay their hands on financial resources to expand very rapidly, incurring in risks that the minority shareholders of the various companies of the groups and the banks involved would not have run.

The growth of the major groups, in terms of assets controlled, was spectacular. At the end of 1982, the two principal economic groups absorbed 50 per cent of lending by the private banking sector. Their shares had a representation of 68 per cent in the portfolios of mutual funds, and 83 per cent of the turnover of the Santiago Stock Exchange was in shares of their corporations (Barandiarán and Hernández, 1999).

Finally, the banks used the state as an insurer in case of bankruptcy, since the government itself had given signals that it would act in that manner by taking over some troubled financial institutions between 1977 and 1981. Given the enormous adverse macroeconomic externalities of bank failures, the state was obligated to intervene in cases of crisis, but it had abdicated the regulatory tools needed to prevent such an event from taking place.

When the terms of trade deteriorated in 1981 and the Federal Reserve raised interest rates sky high, Chile, like most other heavily indebted Latin American countries, began to face serious problems in servicing its debts. After the Mexican debt crisis, the whole castle of cards fell. Foreign credits were not renewed, banks began to call in their loans, the two main groups (and smaller ones as well) collapsed, and the banks were unable to pay their foreign creditors. The Central Bank had to intervene by, in effect, nationalizing private debts and taking over the banks themselves.

This story, which may seem like history today, has important implications for corporate governance. When groups are allowed to own banks, they are tempted to use the funds of depositors for their own purposes, to the detriment of non-group shareholders, depositors, and, ultimately, the state. The consequence is that capital markets cease to function: they are prone to crises that spread rapidly to the real economy. In the Chilean case, the crisis led to a fall in GDP of 15 per cent in 1982-83, a rate of open unemployment that reached 22 per cent at the trough of the depression, and a complete cessation of investment. The financial system in effect collapsed.

As a consequence of the crisis, Chile adopted much more sophisticated norms of banking regulation. Banks are strictly prohibited from making loans to related parties, they must match assets and liabilities in foreign currency, and regulators evaluate the quality of their portfolio periodically. Norms for classifying assets as non-performing have been tightened, banks must make adequate provisions for bad loans, and regulators have the authority to force banks to increase their reserves when they deem that asset quality has deteriorated.

The corporate sector has also gone through a learning process and is more aware of the dangers of taking on excessive debt, particularly in hard currency. As already noted, the level of debt of most Chilean corporations is very conservative. Most of the Chilean groups that survived the crisis have a strong base in a single sector of economic activity. The freewheeling conglomerates of the late 1970s simply disappeared.

### **IX. Does the Chilean capital market do a good job in intermediating saving and investment?**

As discussed in this paper, Chilean corporate governance structures have certain deficiencies, the corporate sector is highly concentrated, and control over much of the corporate sector is exercised by a very small number of powerful groups. These traits would suggest that the capital market functions poorly as an intermediary between savers and investors.

On the other hand, Chilean corporate law is considerably more friendly to the interests of non-group shareholders and outsiders than what one would expect to find in an "insider" system of corporate governance. In addition, for the last 15 to 20 years Chilean capital markets have witnessed the emergence of important new institutional investors. These institutional investors are beginning to provide an important counterweight to controllers. Their very existence has improved the transparency of markets, as firms wishing to place their issues with such investors must provide by law considerable more information about their operations. As noted, banking regulation has also helped to improve corporate governance. So has an activist securities regulator.

It is difficult to judge the extent to which the capital markets are fulfilling the function traditionally assigned to them: to provide efficient mechanisms to intermediate between savers and investors. As already noted, one segment is still quite undeveloped: the bond market. In addition, there is little that can be called "venture capital" in Chilean capital markets.

But the Chilean stock market is relatively large. As a share of GDP, during the 1990s, market capitalization fluctuated between 71 and 134 per cent, depending on the buoyancy of the stock market. The Chilean corporate sector undertakes a large share of all private investment. However, the liquidity of the stock market is still very low. As can be seen in table 4, the ratio between turnover and market capitalization fluctuated between 6 and 15 per cent during the 1990s, which compares very unfavourably with the New York stock exchange (46 per cent in 1992) and London's (61 per cent). The Chilean ratio is even lower than those found in other insider systems (Frankfurt, 75 per cent, and Tokyo, 27 per cent, both for 1991; data taken from Majluf et al., 1998, p. 115). The low share of turnover in capitalization is due, no doubt, to the high degree of concentration of ownership in Chilean corporations: large owners do not trade their shares. Of the almost 300 companies that are listed, only a handful trade every day.

[Insert table 4]

On the other hand, the Chilean stock exchange has been an interesting vehicle for the issue of new shares. A surprisingly large percentage of all turnover is represented by the issue of new shares. This percentage reached the phenomenal figure of two-thirds in 1997. This relatively good performance of the stock market as an intermediary for new investment finance is, of course, partly a statistical artefact and owes as much to a high numerator as to a very reduced denominator. However, it remains true that problems of corporate governance have not inhibited non-controlling investors from snapping up new share issues and have not impeded firms from attempting to raise capital for new projects. Up until 1998, the 1990s had been a good period for issuing new shares, since equity prices rose very significantly as the economy boomed.

The number of firms to go public also rose substantially. In the period 1991-97, the number of firms listed on the Santiago Stock Exchange rose from 223 to 294. Up until the early 1990s, most of the new firms appearing in the stock market were privatized state-owned enterprises. Until then, there were no initial public offerings (IPOs) in the technical sense: companies going public and retaining the services of an investment bank to do so. By contrast, during the 1990s, practically all of the new firms going public were former privately held companies offering shares through IPOs. In 1991-97, there were 44 IPOs valued at US\$ 1,157 million.

IPOs represented almost 5 per cent of all market turnover between October 1991 and May 1997 (Celis and Maturana, 1998).<sup>9</sup>

The IPOs were fairly big by Chilean corporate standards. The average size for the entire period 1991-97 was US\$ 32 million, rising to almost US\$ 70 million in 1996-97. They include a wide array of companies, from group affiliates to family-owned firms to subsidiaries of MNEs. The sectors of the economy are also widely represented: pharmaceutical retailers, department stores, supermarkets, footwear producers, consumer goods, fisheries, and mining. Most of these IPOs were successful, in the sense that share prices rose well above the levels of the initial offer. This was especially so for IPOs earlier in the decade.

Owing to the downturn in the stock exchange as a result of contagion from the Asian crisis, no new firms have gone public since 1997. An attempted IPO in 1999 by an assembler of buses failed and was withdrawn. A handful of the IPOs launched late in the process experienced price declines, and their shares were subsequently repurchased by their majority owners.

Therefore, it cannot be argued that problems with corporate governance have significantly inhibited the capital market from performing its role. Undoubtedly, more transparent practices of corporate governance would improve the functioning of capital markets, and the authorities are keenly aware of this.

## **X. Conclusions**

The Chilean system of corporate governance is a typical example of the "insider" variety. Its main problem is the conflict of interest that arises in such systems between controllers, usually a large group, and outside interests, normally AFPs, national and foreign mutual funds, insurance companies, holders of ADRs, and individuals. The result is that the stock market is rendered more illiquid than it would be otherwise, and its usefulness as a mechanism to raise investment funds is reduced.

Nor can the Chilean corporate sector fully take advantage of the benefits of insider systems. By reducing the agency problem between managers and owners (which tend to be the same), an insider system should make potential bondholders more willing to lend to a company with the characteristics of the typical Chilean corporation. However, the bond market is poorly developed in Chile. The only issuers of bonds on a significant scale are public utilities, telecoms, mining companies, and a handful of very safe manufacturers. And an important proportion of these bonds are issued on international markets, not the Chilean market, which is highly illiquid for this type of instrument.

Chilean banks normally do not lend for investment purposes. Banks face a problem of asymmetry of risks in making long-term loans: if the project for which they lend does not succeed, they risk losing their entire loan; if the project succeeds, they do not share in the pay-off.

That is why it is so important to have an active stock market. Individuals and firms with good ideas are more likely to be able to raise funds in stock markets than through bank lending. The Chilean stock market is playing this role only partially. There have been substantial placements of new share issues on the Chilean stock exchange since the early 1990s. However, the larger firms prefer to issue ADRs in New York. For the smaller firms, the venture capital market is still in its infancy, and the junk-bond market is non-existent.

Improving corporate governance can play a role in deepening capital markets and in making them more effective instruments for channelling resources to firms with good investment projects. In recognition of the importance of the issue, a new law on corporate governance was passed by the Chilean Congress in October 2000. This law ought to do away with some of the most notorious vices of the system as it has existed in recent years. However, the opt-out provisions with regard to tender offers (for a period of three years), together with a lacklustre economic environment and low interest rates, are probably leading to a further, if temporary, drying up of liquidity in the stock market.

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<sup>9</sup> Information based on 36 of the 44 IPOs that took place during this period.



By developing country standards, then, corporate governance practices are quite advanced in Chile, for reasons that are not usually discussed in the corporate governance literature. In this respect, the Chilean experience has some positive lessons for other countries that are usually overlooked. Good corporate governance in Chile is intimately related to appropriate banking supervision. *Per contra*, most developing countries have poor banking supervision practices, and, consequently, suffer from severe problems of corporate governance that corrupt the workings of capital markets. In most developing countries, economic groups own banks, through which they are able to extract rents not only from non-group shareholders but from very broad sectors of society, including the government, which is left with little option but to guarantee the safety of depositors. Corporate governance improved in Chile since the banking crisis of 1982-83, mainly as a consequence of the adoption of good banking supervision.

The other lesson from the Chilean experience is that corporate governance improves substantially when well-regulated institutional investors enter the scene. This may have been an unexpected bonus from the pension fund reform of 1981. Countries contemplating a pension fund reform could well chalk up improvements in corporate governance to the asset side of the reform ledger. The system, when it functions well can add transparency to the operation of capital markets and can perform the function of monitoring controllers. Because of collective action problems, small shareholders cannot perform this task. Individual action is too costly relative to the benefits even for a relatively large shareholder (as evidenced by Templeton's withdrawal from the Terra suit), and each small shareholder always has the temptation to behave as a free rider.

The AFPs have the potential for playing a much more important role in disciplining corporations and limiting the extraction of rents by controllers. As noted, in recent years, they already have been a positive force in this direction. If their role as investors in corporations were increased, transparency in corporate governance could be improved still further, and the stock market's liquidity could thereby be increased.

The AFPs can also be instrumental in helping to create a genuine and liquid bond market. Corporate bonds are very appropriate vehicles for the AFPs, since they have a long-term horizon and are particularly concerned about the security of their investments.

At present, despite the recent introduction of risk-segregated portfolios, the AFPs are still hamstrung by overly stringent regulations. They are allowed to hold a small proportion of the value of a company's capital, which limits the power they can exercise over company affairs. In the bond market, they cannot purchase non-investment grade bonds. This is a major reason why there is no junk bond market in Chile. AFPs could even be allowed to invest part of their resources in venture capital undertakings, something they cannot do at present. These weaknesses in Chilean capital markets increase the difficulties that small and untried firms encounter in raising investment capital resources.

For big AFPs, these regulations are particularly onerous, since they make it very difficult for them to change the structure of their portfolios. While seeking to protect the interests of contributing workers, such regulations hamper the development of capital markets. Perhaps the rules that govern the investments of AFPs could be made more flexible, at the same time strengthening the supervision of their activities.

Ultimately, then, the development of capital markets is not just a matter of improving corporate governance. The evolution of capital markets is part of the process of economic development. Where capital markets fail or are undeveloped – as in most emerging markets, including Chile's – they need to be supplemented by public action. In this area, the basic issue for developing economies is how to ensure that small and medium size firms have adequate access to investment resources. A more liquid stock market might help. But one suspects that is not enough and that a specific role for government in fostering the creation of missing markets is unavoidable.

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**Table 1**  
**Chile's five most important groups in 1994**

| Groups        | Market value<br>(million US\$) | Share of market<br>capitalization | Number of<br>related firms | Origin |       | Directors<br>controlled by<br>group | Total<br>Directors of<br>member<br>companies |
|---------------|--------------------------------|-----------------------------------|----------------------------|--------|-------|-------------------------------------|--|
|               |                                |                                   |                            | Family | State |                                     |  |
| Angelini      | 8,426.8                        | 12.4                              | 86                         | x      |       | 27                                  | 29   |
| Luksic        | 3,844.3                        | 5.7                               | 93                         | x      |       | 38                                  | 40   |
| Matte         | 5,232.2                        | 7.7                               | 69                         | x      |       | 13                                  | 16   |
| Pathfinder    | 1,764.7                        | 2.6                               | 18                         |        | x     | 13                                  | 17   |
| Sigdo Koppers | 825.8                          | 1.2                               | 37                         |        | x     | 30                                  | 39   |
| <b>TOTAL</b>  | <b>20,093.8</b>                | <b>29.6</b>                       | <b>301</b>                 |        |       | 121                                 | 141  |

Source: Majluf et al. (1998).

Table 2

A characterization of the Chilean corporate sector, September 1999

(177 companies, percentages)

| Sector                       | Sample size | Cumulative ownership |             | Debt-equity ratio |             |             | Share in liabilities |            |                 |
|------------------------------|-------------|----------------------|-------------|-------------------|-------------|-------------|----------------------|------------|-----------------|
|                              |             | 3 largest            | 10 largest  | Short-term        | Long-term   | Total       | Banks                | Bonds      | Related parties |
| Agriculture                  | 20          | 72.9                 | 90.4        | 31.9              | 24.8        | 56.8        | 52.0                 | 0.0        | 17.0            |
| Mining                       | 6           | 79.3                 | 93.3        | 19.7              | 19.2        | 39.0        | 30.0                 | 0.4        | 15.6            |
| Manufacturing                | 53          | 76.0                 | 90.5        | 35.3              | 20.9        | 56.2        | 32.9                 | 6.8        | 19.0            |
| Electricity and water        | 18          | 75.5                 | 86.3        | 22.7              | 57.3        | 80.1        | 27.2                 | 7.7        | 24.7            |
| Construction                 | 1           | 61.1                 | 89.9        | 29.1              | 3.3         | 32.4        | 1.9                  | 0.0        | 29.2            |
| Commerce                     | 10          | 76.2                 | 92.8        | 88.2              | 47.6        | 135.8       | 43.4                 | 0.0        | 23.4            |
| Transport and communications | 11          | 80.7                 | 93.5        | 76.9              | 63.5        | 140.4       | 25.8                 | 11.3       | 25.0            |
| Finance                      | 50          | 68.1                 | 85.9        | 24.2              | 23.9        | 48.1        | 39.4                 | 2.9        | 24.7            |
| Services                     | 8           | 74.1                 | 78.2        | 68.2              | 31.6        | 99.8        | 34.5                 | 1.7        | 14.8            |
| <b>Total</b>                 | <b>177</b>  | <b>73.6</b>          | <b>88.6</b> | <b>37.0</b>       | <b>30.4</b> | <b>67.4</b> | <b>36.4</b>          | <b>5.5</b> | <b>21.4</b>     |

Source: Authors' calculations based in Superintendencia de Valores y Seguros, FECU form, September 1999.

**Table 3**

**Sources and uses of funds in Chilean corporations: 1981–94**  
(percentage of total)

|                               | <b>1981</b> | <b>1986</b> | <b>1990</b> | <b>1994</b> |
|-------------------------------|-------------|-------------|-------------|-------------|
| <b>Sources of funds</b>       |             |             |             |             |
| Own resources                 | 51.1        | 78.1        | 65.3        | 63.7        |
| Cash flow                     | (7.3)       | (37.0)      | (35.8)      | (32.6)      |
| Debt                          | 47.5        | 18.2        | 21.8        | 15.2        |
| Bonds                         | --          | 1.8         | 7.2         | 5.2         |
| Share issues                  | 1.3         | 1.9         | 5.7         | 16.0        |
| <b>Total</b>                  | 100.0       | 100.0       | 100.0       | 100.0       |
| <b>Uses of funds</b>          |             |             |             |             |
| Fixed investments             | 18.0        | 25.0        | 36.0        | 22.1        |
| Financial investments         | 68.6        | 40.8        | 24.1        | 37.5        |
| Decrease in debt              | 18.7        | 21.5        | 16.3        | 16.8        |
| Dividends                     | 6.8         | 9.3         | 26.1        | 20.5        |
| Investment in working capital | -12.1       | 3.4         | -2.5        | 3.2         |
| <b>Total</b>                  | 100.0       | 100.0       | 100.0       | 100.0       |

Source: Agosin, Crespi, and Letelier (1999), p. 123.

**Table 4**  
**Stock market indicators, 1991-99**  
(in millions of US dollars)

|             | Number of enterprises traded | Market turnover | Market capitalization | Market capitalization (% of GDP) | New share issues | IPOs, total value | IPO, average value | Turnover/Capitalization (%) | New issues/Turnover (%) | IPOs/Turnover (5) |
|-------------|------------------------------|-----------------|-----------------------|----------------------------------|------------------|-------------------|--------------------|-----------------------------|-------------------------|-------------------|
| <b>1991</b> | 223                          | 1,922           | 28,381                | 81.9                             | ..               | --                | --                 | 8.2                         | ..                      | ..                |
| <b>1992</b> | 244                          | 2,072           | 29,808                | 71.2                             | ..               | 162 <sup>a</sup>  | 20                 | 7.0                         | ..                      | 7.8               |
| <b>1993</b> | 263                          | 2,659           | 45,179                | 101.6                            | ..               | 171               | 16                 | 5.9                         | ..                      | 6.4               |
| <b>1994</b> | 279                          | 5,480           | 67,992                | 133.5                            | 2,119            | 87                | 22                 | 8.1                         | 38.7                    | 1.6               |
| <b>1995</b> | 282                          | 10,740          | 72,718                | 106.1                            | 2,307            | 112               | 28                 | 14.8                        | 21.4                    | 1.0               |
| <b>1996</b> | 290                          | 8,255           | 66,243                | 96.6                             | 3,430            | 624 <sup>b</sup>  | 69                 | 12.5                        | 41.6                    | 7.6               |
| <b>1997</b> | 294                          | 7,119           | 72,081                | 95.1                             | 4,809            | ..                | ..                 | 9.9                         | 67.6                    | ..                |
| <b>1998</b> | 287                          | 4,307           | 51,961                | 71.2                             | 1,951            | ..                | ..                 | 8.2                         | 45.3                    | ..                |
| <b>1999</b> | 282                          | 6,388           | 67,160                | 99.9 <sup>c</sup>                | 721 <sup>d</sup> | ..                | ..                 | 9.5                         | ..                      | ..                |

**Sources:** Authors' calculations, based on Bolsa de Comercio de Santiago, *Reseña Anual*. Volumes from 1991 through 1999; data of Superintendencia de Valores y Seguros; and Celis and Maturana (1998, p. 16).

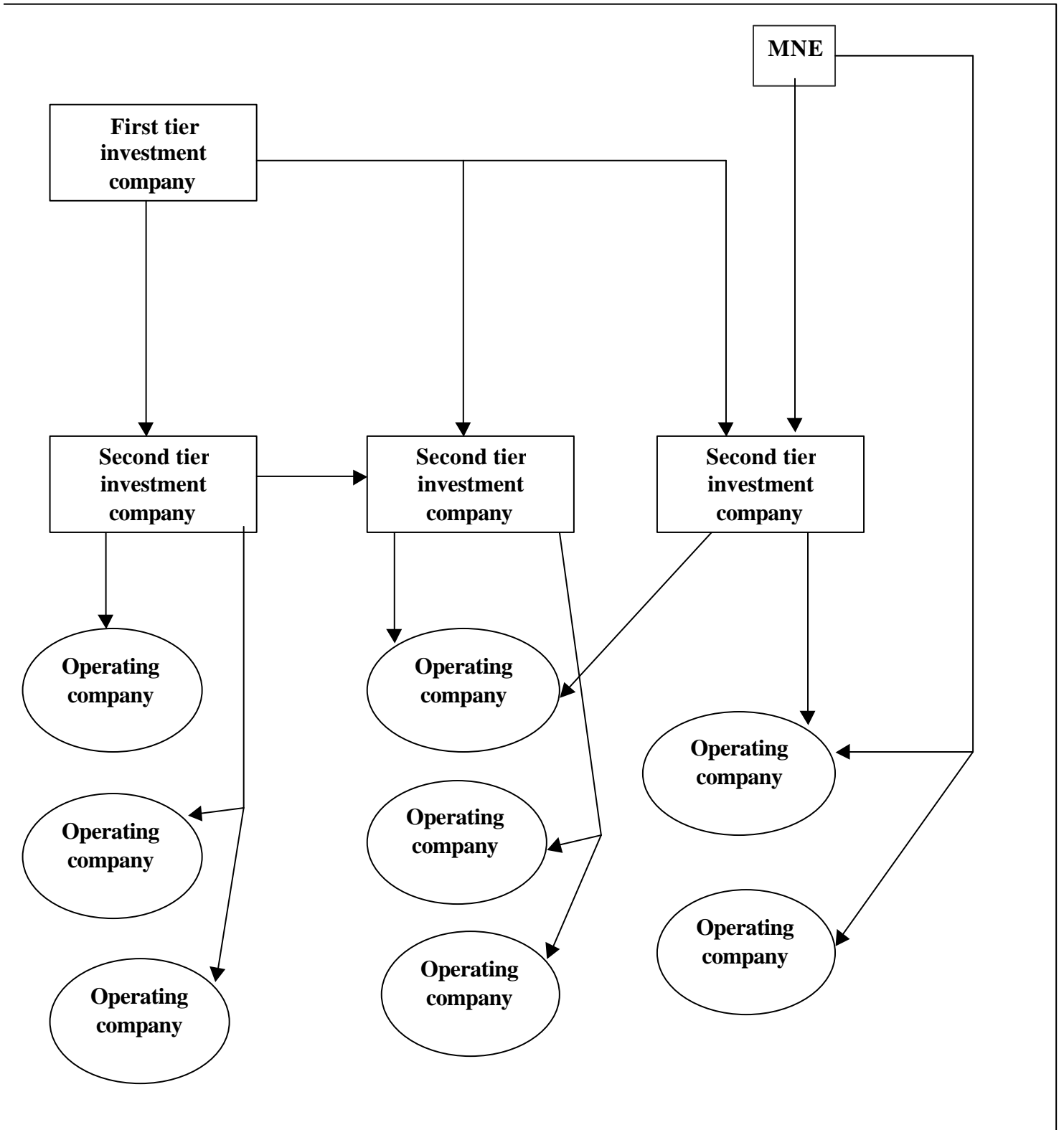
<sup>a</sup> October 1991- December 1992.

<sup>b</sup> January 1996 - May 1997.

<sup>c</sup> 1999 GDP is estimated.

<sup>d</sup> January - June 1999.

Figure 1  
Stylized structure of Chilean economic group



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