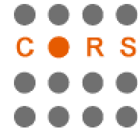


The Evolution of Business Groups in Brazil, Chile and Argentina 1990-2003: How the State Affects Corporate Governance through Business Financing

Silvia Garcia de Agnelli

School of Public Policy and Administration, Carleton University
Room 5224, River Building
Ottawa, Canada K1S 5B6

silvia_garcia@carleton.ca

Abstract

This paper argues that the different pattern of evolution of business groups in Brazil, Chile and Argentina between 1990-2003 is better explained by differences in state involvement in corporate financing, than by state policies towards investor protection. Business groups are firms bound together by equity and social ties sometimes structured in a pyramidal way with a controlling wealthy family owner in the apex. Such business groups, ubiquitous in developing countries, went through a period of restructuring in the 1980's and 1990's in Brazil, Chile and Argentina. Two decades after this restructuring period, new groups emerged in Brazil, existing ones expanded in Chile, while they were sold out in Argentina. This paper aims to explain why the pattern of evolution of business groups in the three countries followed such different paths. The corporate finance literature on business groups focuses on the conflict of interest between controlling shareholders and investors and argues that business groups are prominent when minority investor protection is poor. We argue that the nature of investor protection is not a satisfactory basis for explaining the different pattern across these countries and that state involvement in corporate finance was a critical factor in establishing the cross-country pattern observed for Brazil, Chile and Argentina. Business groups emerged or expanded (were bought out) if the state was (not) involved in equity financing of business groups. The State channeled public savings to business groups in the form of equity in Brazil and Chile through state related institutions and a mandatory private pension system, respectively. In Argentina, business groups were mainly financed with foreign loans. During the financial crisis of the late 1990's, business groups already highly indebted sold their assets in Argentina while business groups in Brazil and Chile could share losses with domestic investors.

Key words: *Business groups, business financing policies, Brazil, Argentina, Chile*

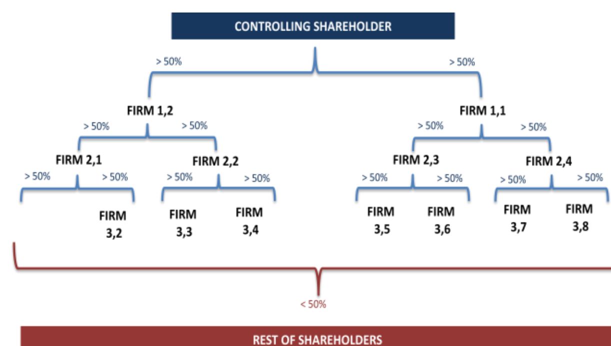
THE EVOLUTION OF BUSINESS GROUPS IN BRAZIL, CHILE AND ARGENTINA 1990-2003: HOW THE STATE AFFECTS CORPORATE GOVERNANCE THROUGH BUSINESS FINANCING

1. Introduction to the Study of Business Groups

Early studies on business groups have emphasized the developmental role of business groups in state led industrialization (Rosenstein-Rodan 1943; Gerschenkron 1962) and their rent seeking activities and 'crony capitalism' (Krueger 1974). Recent studies have explained their economic diversification (Khanna and Palepu 1997); their network (Granovetter 2005) and pyramidal structure (La Porta et. al. 2000; Morck et. al. 2005) as well as the link between corporate structure and politics (Gourevitch and Shinn 2005). Consensus exists about their origin. They were family corporations close to and supported by the state (Khanna and Yafeh 2007). Some scholars (Evans 1995; Woo-Cummings 1999) argue that 'developmental states' target some strategic industries to foster rapid economic development and build up interdependent industries simultaneously. If this were *exclusively* led by business, development may be blocked due to capital constraints, hold-up problems, and spillovers between industries. If this were *exclusively* led by the state (Rosenstein-Rodan 1943), it may not succeed because investment decisions may be guided only by political concerns compromising economic efficiency. A better option appears if the state delegates *'big push' coordination* to business groups (Morck 2005). As business groups are diversified, they operate in several sectors. As they control several firms, they may subsidize some units with the profits of others. Due to their centralized control, they can coordinate investments eliminating hold-up problems and competition among them may induce efficiency. State support to business may include market protection, export promotion, privatizations, tax exemptions, and cheap access to labor/technology/capital. Some authors find this last element crucial for development (Evans 1995). According to them, the state should organize financial markets, serve as investment banker (Gerschenkron 1962) and induce risk-taking business (Hirchman 1958). On the other side, others (Shleifer and Vishny 1994) warn about the consequences of state control over finance arguing financial resources are more likely to be allocated for the sake of votes or bribes. Finally, business-government relations tend to be cozy during business groups' emergence due to state support, but if business groups become powerful, they may favor opponents to the group in power and government may want to harm them (Schneider 2010).

One way of organizing big business is the free standing and widely held firm controlled by managers in which ownership is diffuse among shareholders. Another one is the business group in which few shareholders own large blocks of shares and control decisions. Here, the organizational structure is usually a network or a pyramid. The latter prevails in Latin America. So, adapting the definition provided by Khanna & Yafeh (2007), we will consider a *business group as a set of legally independent firms usually operating in diversified sectors and organized after the fashion of a pyramid with a controlling shareholder located at the apex.* The controlling shareholder, usually a wealthy family, exerts control over all the firms of the group, whose collective value is far beyond its own wealth. Consider figure 1. The controlling shareholder owns a minimum of 51% of the voting shares of the firms in the first upper tier of the pyramid. Each first tier firm owns a minimum of 51% of the voting shares of the firms in the following tier, and so on. Further, the controlling shareholder may choose for the strategic positions in the group people from its familiar/social circle. Thus, equity and social ties among firms let the controlling shareholder control not just one firm but many firms that collectively are worth substantially more than its own wealth (Morck et al 2005). This is interesting because if a controlling shareholder wants to operate its business at a bigger scale, funds beyond its own capital are needed. Yet, the controlling shareholder of any firm risks losing control of the business either financing with equity because it dilutes control or financing with debt because it raises bankruptcy risk. A pyramidal business group is a better alternative because it allows the controlling shareholder to lower bankruptcy risks by financing through equity from outside investors while securing its control of the business. As a consequence, the controlling shareholder can lift assets/income from lower to higher tier firms and dump liabilities/losses from higher to lower tier firms, a phenomenon called 'tunneling' (Chong and Lopez de Silanes 2007).

Figure 1. A Simplified Control Pyramid



Source: Author based on Morck et al (2005)

2.2. Evolution of Domestic Business Groups in Brazil, Chile, and Argentina

The origin of many business groups in these countries can be associated with the market protection enjoyed by domestic firms under ISI policies implemented in the region between 1940 and 1970. Their larger participation in the economy in the following decades can be linked to the privatization of state-owned firms, created under those ISI policies, in the 1980's/1990's. They followed different paths across countries since then.

As summarized in Table 1, privatizations in Brazil gave birth to new domestic business groups. The expansion that many domestic business groups experienced over the period was due to their participation in privatizations or to the internationalization of their business. In either case, firms were supported by the state through BNDES[i]. This performance was not related to any particular sector of the economy. Among the business groups that expanded there were very diversified ones as well as focused ones. This period brought economic concentration of resources in the hands of domestic business groups in electric energy, steel, petrochemicals, as well as transport and infrastructure, mainly due to privatizations. Foreigners also concentrated resources due to mergers and acquisitions (food and beverages, steel, textiles, and banking) and to a lesser extent due to privatizations (telecommunications and electric energy). Overall, all domestic business groups that took part in privatizations fared well.

Domestic business groups in Chile consolidated and expanded mainly through internationalization, as shown in Table 1. Direct state support to this strategy was mainly export promotion. Privatizations as well as mergers and acquisitions contributed to the expansion of business groups favoring the concentration of the economy in the hands of domestic business groups (natural resources and retail) and foreigners (financial services and utilities) that together controlled 90% of the assets of the biggest firms in 2002. One domestic business group emerged due to the development of the Chilean financial market, which also allowed for the expansion of existing business groups (Colpan et al 2010, 395-397). Overall, all domestic business groups fared well between 1990 and 2003. Many participated in privatizations over the period or previously.

Unlike Brazil, privatizations in Argentina did not create new domestic business groups, but were the raison behind the initial expansion of many of them, as summarized in Table 1. Internationalization was another source of initial expansion, yet not supported by long standing governmental agencies or systematic policies like in Brazil or Chile.

Mergers and acquisitions were sometimes sources of expansion while sometimes signs of restructuring, shrinking, or elimination of business groups. Like Brazil and Chile, they were also the way in which foreign capital increased their participation in the economy. Indeed, domestic business groups in Argentina owned two-thirds of the firms belonging to big business units in 1993; half of them in 2000 (pre-default); and foreign corporations owned almost 60% of them in 2003. There was a net loss in the number of total firms over the period. Unlike Brazil and Chile, half of the domestic business groups studied fared badly, half of which had previously expanded through privatizations in oil, electric energy, transport and infrastructure, steel and petrochemicals. Finally, among the three domestic business groups that emerged over the period, one of them ceased to exist by 2003 adding to the elimination of two existing business groups.

How is it possible that their evolution was so similar across countries over the century and so different by the beginning of the twenty-first century? Why did they become more and bigger in Brazil, the same and bigger in Chile, and less and smaller in Argentina?

Table 1. Evolution of Business Groups in Brazil, Chile and Argentina, 1990-2003
Number of business groups between brackets

	BRAZIL	CHILE	ARGENTINA
GROWTH	Emergence (8) Expansion (16)	Emergence (1) Expansion (19)	Expansion (18)
CONTRACTION	M&A (7) Financial distress (1)	NA	M&A (8) Financial distress (11) Ceased to exist (2)
STYLIZED RESULT	EMERGENCE & EXPANSION ACQUISITIONS BY FOREIGNERS	EXPANSION	SHRINKING & ELIMINATION ACQUISITIONS BY FOREIGNERS

Source: Author based on Colpan et al (2010)

3. Literature Review

We review the two sets of works we consider the most relevant for our research puzzle. They are summarized in the table below.

Table 2. Literature Review on the Political Economy of Business Groups

Approach	Main Argument	Authors
ECONOMIC COORDINATION	Business Groups reflect higher economic coordination and weaker investor protection	Gourevitch & Shinn (2005)
INVESTOR PROTECTION	Business Groups are more prominent in contexts of weak investor protection	La Porta et al (1999); Khanna & Yafeh (2007)

3.1. Business Groups and Economic Coordination

A first possible explanation for our puzzle is linked to the idea that business groups are the result of policies privileging coordination over competition as allocative mechanism of the economy. This explanation is associated with the study of corporate governance forms by Gourevitch and Shinn (2005) based on the 'varieties of capitalism' literature. In this context, the degree of coordination of the market economy refers to the channel that a firm privileges in order to do business. Lower degrees of coordination would be necessary if the market and the legal system were privileged (liberal market economy). Higher degrees of coordination would be necessary if collaborative relationships and exchange of private information inside networks were privileged (coordinated market economy). According to Gourevitch and Shinn, freestanding and widely held firms are the result of more liberal market economies and stronger investor protection policies while business groups are the result of more coordinated market economies and weaker investor protection. In this approach, shareholders, managers, and workers are key actors trying to build political coalitions with others inside and outside the firm to set the coordination and investor protection policies that favor their interests (Gourevitch and Shinn 2005).[ii] Although, we do agree on the relevance of politics and policies to explain corporate forms, we think the public policies at the center of this approach are not the significant ones for solving our puzzle. We find our puzzle cannot be explained by the economic coordination of the economies in Brazil, Chile, and Argentina simply because the privileged mechanisms through which firms do business in Latin America are not considered either coordinated or liberal, as pointed out by Schneider (2009). According to this author, hierarchical mechanisms within business groups, foreign firms, and the labor market characterize these economies, replacing or attenuating the coordination or competition mechanisms found elsewhere. Further, the theoretical framework developed by Gourevitch and Shinn does not pay too much attention to the state; whole role is a significant one when studying late developers, also underlined by Schneider (2009). Moreover, this approach is rather static, with no room for change in policies other than change in political coalitions. So, it is not well suited for explaining change/evolution. Last, investor protection policies are not a satisfactory variable either, as we show next.

3.2. Business Groups and Investor Protection

A second possible explanation is that business groups have the capacity to expropriate dividends from investors with the implicit consent of the state. This fact would explain superior performance. This is a standard thesis found in the literature on law and

economics. Its argument relies on corporate governance forms and is summarized as follows. We recall here that *a business groups is a corporate form consisting of a set of legally independent firms bound together by equity and social ties, usually operating in diversified sectors and organized after the fashion of a pyramid with a controlling shareholder located at the apex. The controlling shareholder is often a wealthy family that exerts control over all the firms of the group, whose collective value is far beyond its own wealth. This structure allows the controlling shareholder to lower bankruptcy risks by financing through equity from outside investors while securing its control of the business. Further, it allows the controlling shareholder to 'tunnel' dividends that should go to investors to other purposes, in other words, to 'expropriate' investors.* The legal system provides a mechanism for resolving this conflict through investor protection rights such as voting rights for minority shareholders (La Porta et al 2000). Voting rights (election of directors; decisions in general meetings) are key features of equity assuring outside investors that their dividends will be paid. Without them, equity would be worthless. So, the main instruments for protecting these rights are found in corporate, securities, and bankruptcy laws; stock exchange and government regulations; as well as corporate self-regulations and accounting standards. Equally important is their enforcement by courts, regulators, and market participants (Chong and Lopez de Silanes 2007). In contexts where investor protection remains weak, the conflict between controlling shareholders and investors worsens and the problems of 'tunneling' are more severe, pyramidal business groups are more prevalent and control over firms tend to be concentrated in the hands of either wealthy families or the state. This negative relation between investor protection and business groups is backed by significant empirical evidence (La Porta et al 2000; Khanna & Yafeh 2007; Chong & Lopez de Silanes 2007). Some scholars have already questioned the extent to which this negative relation can explained the evolution of business groups in developed countries. This is the case of Morck (2005) who found investor protection was a poor candidate for explaining the evolution of Canadian Business groups in the twentieth century. In contrast with Morck, we study the comparative pattern of the evolution of business groups in three developing countries from a region where investor protection is the weakest among all the regions of the world. In agreement to him, we do not think that the negative relation between investor protection and business groups can explain our puzzle. As shown in Table 3, there is no evidence that supports such correlation between the evolution of business

groups observed over 1990-2003 and the evolution of investor protection during the same period. Investor protection has remained stable or improved in Chile and Brazil, instead of deteriorating as predicted in this standard approach. In contrast, it has deteriorated in Argentina instead of improving. So, the evolution of investor protection seems a poor candidate to explain the evolution of business groups in Brazil, Chile, and Argentina during 1990-2003.

Table 3. Investor Protection & Business Groups in Brazil, Chile and Argentina, 1990-2003

Country	Investor Protection			Evolution Investor Protection	Evolution Business Groups	Correlation consistent with investor protection hypothesis?
	Minority Shareholder Rights	Law Reforms	Enforcement			
Brazil	Slightly Improving	Yes	Deteriorating	Slightly improved	Fared well	No
Chile	Slightly deteriorating	Yes	Slightly deteriorating	Stable	Fared well	No
Argentina	Deteriorating	No	Strongly deteriorating	Deteriorated	Fared badly	No

Source: Author based on Chong and Lopez de Silanes (2007).

One should note, however, that the *evolution* of investor protection cannot be related to the *evolution* of business groups does not mean that low levels of investor protection cannot be associated with the existence of business groups. Although not our research question, we do agree with the literature (La Porta et al 2000) that argues and supports empirically that under lower levels of investor protection, business groups are more prominent.

4. Our Explanation

What explains the different patterns of evolution of business groups in Brazil, Chile, and Argentina over 1990-2003? We propose here an explanation that relies on a literature that could be called the "political economy of corporate governance". We argue that:

Business groups fared well if equity-financing policies were available

Business groups fared badly if equity-financing policies were not available

We will show that business groups fared well in Brazil and Chile because the state provided equity financing either directly (equity held by the public sector) or indirectly (equity held by private pension funds) to business groups. This affected the governance

structure of business groups enabling them to finance with equity from domestic sources without losing corporate control while keeping the level of bankruptcy risk under control in face of negative external financial shocks. In contrast, business groups fared badly in Argentina because, already highly indebted in foreign currency, they were crowded out by the State from financial resources in face of negative external financial shocks.

4.1. Business Groups' Financing in Brazil, Chile, and Argentina over 1990-2003

In Brazil, a large and concentrated banking sector provided most of its funds through treasury securities to the Brazilian State (Chong & Lopez de Silanes 2007, 216), which owned the two largest commercial banks *Banco do Brasil* and *Caixa Economica Federal* (Stallings 2006, 233) through which it channeled funds to a variety of economic sectors. Through its development bank BNDES[iii], the State channeled funds to business. The capital market remained underdeveloped; the domestic private banking was never deeply involved in business financing; and foreign banks had a limited role in the Brazilian banking sector (Chong & Lopez de Silanes 2007, 216; Colpan et al 2010, 361-63). So, the main sources of long term business financing were the loans from BNDES and equity from BNDESPAR[iv] and state-related pension funds[v]. BNDES' loans at subsidized interest rates[vi] went to large and profitable firms constituting in average 30% of their total loans by the end of the period under study, thus, reducing their financial expenses in a significant way. The majority of these firms (88%) were not financed with equity by BNDESPAR. However, the majority of the firms (85%) financed with equity by BNDESPAR, did receive loans from BNDES (Lazzarini et al 2011, 6). This last situation was the one of many domestic business groups that participated in privatizations.

In Chile, a few foreign and to a lesser extent domestic business groups controlled the majority of the financial institutions over the period studied (Chong & Lopez de Silanes 2007, 391). The banking sector was composed of six foreign, nineteen private domestic, and one state-owned institution. Foreign banks held 40% of the assets and dominated commercial banking (World Bank 2004, 5). The most important private domestic banks belonged to five domestic business groups, three of which were specialized in financial businesses. Lastly, the Banco del Estado de Chile was the only state-owned institution (World Bank 2004, 5). The private pension funds were the main actors of the capital market that became relatively developed in regional terms after 20 years of operation[vii]. Their portfolios included 40% of the bonds issued by the government. In despite of this and in contrast with Brazil, the State did not absorb many financial resources from the

system. Its domestic debt was moderate and concentrated in Central Bank instruments (World Bank 2004, 3-5). Instead, its role within the financial sector was a regulatory one. One of its most relevant regulations was the separation of financial from industrial business groups in the mid 1980's. Since then, business groups in Chile were unable to rely on lending from their own banks and had to operate their financial business independently from their other operations. Another relevant regulation was implemented in the 1990's when pension funds were authorized to invest in equity holdings (Chong & Lopez de Silanes 2007, 292-3). By the end of the period under study, equity holdings from 90 listed firms represented 38% of their portfolios, which also included 40% of the bonds issued by corporations (World Bank 2004, 3-5). By the same time, all the existing pension funds but one were owned by foreign capital and all of them had held equity in business groups between 1990-2003. Pension funds' holdings represented 10% of business groups' equity. Another 10% was in American Depositary Receipts and 6% was traded in the domestic market (World Bank 2004, 4-5,12).

In Argentina, the financial sector was composed of private domestic, foreign, and public banks as well as an underdeveloped capital market (Chong & Lopez de SIlanes 2007). The main focus of private domestic banks was retail and consumer lending. Foreign banks were mainly focused on mortgages and lending to public utilities companies and the industrial sector. Neither private domestic banks nor foreign banks lent significant amounts to the public sector. The latter depended more on public institutions that remained numerous despite privatizations (World Bank 1998, 10-12, 28). In the mid 1990's, the government attempted to develop the capital market through the introduction of a private pension system that would coexist with the public pension one. By 2000, the six pension funds that concentrated 85% of the members belonged to banks both private and public. Although equity financing was in principle available to the largest firms belonging to business groups through the domestic capital market and through American Deposit Receipts (World Bank 1998, 28), they seldom traded their capital publicly. Indeed, less than 40% of the business groups traded any of the stocks of their firms publicly by the end of the period under study (Colpan et al 2010, 328). Moreover, access to equity financing through private pension funds in Argentina was very limited even for business groups if compared with Chile (World Bank 1998, 3-5, 28). In fact, half of the resources managed by pension funds in Argentina were invested in government bonds by 2000 (Rofman 2000, 47). In short, business groups in Argentina mainly financed

themselves through *debt* from foreign banks and to a lesser extent from private domestic banks over the period studied. Like Brazil, the State captured most domestic savings through public banks. Unlike Brazil, the State did not channel those funds to business neither through a development bank nor through public pension funds, but used them for its own funding. Like Chile, there was an attempt to channel public savings to business through private pension funds and to develop the capital market. Unlike Chile, the public pension system whose resources were managed by the State coexisted and competed with the capitalization system for domestic savings. Unlike Chile, two important pension funds operating in the capitalization system were owned by public banks.

Overall, domestic public savings were available for business in Brazil and Chile. In both cases, the source and form of business financing was reliable and used for at least two decades. Although partial availability, domestic public savings did not constitute a reliable and long-standing source of business financing in Argentina, where business was mainly financed with loans from foreign sources. So, there appears to be a positive correlation between the evolution of business groups and the existence of long standing equity financing policies.

4.2. Business Groups' Financing as Explanation of Business Groups' Evolution

4.2.1. Brazil. Over the period studied, one half of the business groups studied were financed with equity by state related institutions, as shown in Table 4. All the business groups that emerged over the period received equity financing from those institutions. In half of those that expanded state related institutions held equity, while another 30% of them was successful at least in one privatization bid. Thirty percent of those that evolved moderately and 25% of those that shank were equity financed by state related institutions.

In 1998, the international financial crisis originated in East Asian hit Brazil and the State responded with devaluation and fiscal adjustment. Over 1998-2002, state related institutions maintained equity financing to business groups on a selective basis. Three business groups obtained an increase in equity financing from state related institutions and five preserved the previous levels of equity financing. Although two business groups suffered from reductions in equity financing from state related institutions, equity holdings in state hands were maintained at 10% or higher. Equity financing was erratic for three business groups, decreasing one or two times over the period but increasing

again by the end. Finally, four business groups suffered from a reduction or elimination of equity financing from state related institutions. Overall, those business groups in which the state increased, maintained, or assured minimum levels of equity holdings over the years marked by the crisis, emerged, expanded or had a moderate evolution. Those in which equity holdings in public hands were erratic, reduced, or eliminated over 1998-2002, performed worse. The two business groups initially equity financed by the state that shrank over the period, suffered a reduction or an elimination of equity financing. In this context, business groups searched other sources of financing. While domestic financing for business in corporate bonds and bank loans from public and private sources decreased since the beginning of the crisis, foreign credit towards business both under the form of loans and bonds increased. It is worth noting here that foreign financing to the public sector also increased over 1998-2002, yet loans decreased and bonds increased significantly significantly (Stallings 2006, 245, 251).

To summarize, the state selectively maintained equity financing to business over the crisis. Backed by this support, business groups could share losses with domestic shareholders retaining control over corporate decisions due to their pyramidal structure. As bankruptcy risk was under control, they could borrow from foreign sources over the crisis. Having the state as (minority) partner, business groups that emerged because of privatizations and those that expanded over the 1990's fared well over the period studied even if they faced major negative external shocks.

4.2.2. Chile. Over the period studied, seventy percent of the selected firms belonging to the business groups under study were financed with equity held by pension funds, as shown in Table 5. All of them expanded.

When the international crisis hit Chile in the late 1990's, the state responded by interest rate increases and international reserves reductions and lending slowed. The capital market started to shrink after the crisis, but the financial system was not disrupted by the shock (Starrings 2006, 146, 159-160). Pension funds maintained the value of their investments in corporate assets over the crisis. Yet, their holdings in equity decreased while those in corporate bonds increased from 1998 to 2002. Moreover, the relative importance of corporate assets in their portfolios decreased in order to privilege government bonds and assets of financial and foreign institutions (Stallings 2006, 160, 165). Equity financing to most of the selected firms belonging to business groups

increased over 1998-2000, but followed a more selective and erratic evolution between 2001-2003. Pension Funds increased their equity holdings in nine business groups and maintained their level of investment in one over 1998-2000. Their placements in equity increased significantly in three business groups, were more erratic in five cases, and decreased in two other cases between 2001 and 2003. Among the 14 business groups financed with equity over the period under study, ten received same or higher level of equity financing over the first years of the financial crisis. Yet, pension funds held equity more selectively since 2001, privileging some at the expense of others. Further, pension funds did not hold equity or their holdings became negligible in the four remaining cases since 1998. It is worth recalling here that the four latter were operating in financial businesses and pension funds increased other placements in those institutions at the expense of non-financial business over the crisis. In this context, the largest firms relied increasingly on external loans, bonds, and to a lesser extent, domestic loans as sources of financing by the end of the period studied (Colpan et al 2010, 404).

To summarize, pension funds selectively maintained equity financing to business groups. Backed by these actors, business groups could share losses with domestic shareholders retaining control over corporate decisions due to their pyramidal structure. With bankruptcy risk under control and access to international markets, they could increase their borrowings from foreign sources over the crisis. Having foreign financial institutions as the central players of the domestic financial market, business groups that expanded over the 1990's fared well over the period studied even if they faced major negative external shocks.

4.2.3. Argentina. In contrast with Brazil and Chile, there was neither a development bank nor a long-standing pension system providing a reliable flow of domestic funds for equity financing over the period under study. In contrast with Brazil and Chile, business groups mainly sought financing abroad. The stock of the external debt of the non-financial private sector increased from 3,5 billions of dollars in 1991 to 36 billions in 1998. This last year, 75% of the debt corresponded to 59 firms belonging to business groups.

The international financial crisis set Argentina into a currency-growth-debt trap. The level of indebtedness in foreign currency of many business groups made many of them to oppose to changes in the exchange rate policy, narrowing the margins for crisis resolution and delaying decision and policy making. New foreign sources for business

groups' financing became virtually unavailable. Indeed, the stock of debt in international markets held by the non-financial private sector remained at 36 billions of dollars between 1998 and 2000. Highly indebted business groups began to sell their assets in the late 1990's, mostly to foreign firms, to remain liquid or invest in export-oriented activities. Pension funds reduced drastically their investments in corporate assets in general and in equity in particular, from 24% and 22% in 1997 to 8% and 7% in 2002, respectively (Kulfas and Schorr 2002, 30-36). Furthermore, the participation of government assets in pension funds' portfolios in Argentina increased constantly since 1997 reaching 78% in 2002. Indeed, the state crowded out business from the financial resources managed by pension funds in Argentina (Fanelli et al 2002). Although the financial packages received from the IMF in 2000 and 2001, Argentina experienced mounting capital outflows in late 2001. This resulted in deposit freezing, further default on the country's official foreign debt, devaluation, and floating of the peso in 2002. This time, more business groups sold part or all of their assets or went bankrupt.

To summarize, despite the potential benefits of equity financing that lie behind their pyramidal structures, business groups in Argentina were financed with debt nominated in dollars from foreign sources over the period under study. Having initially limited access to domestic savings in equity or debt, business groups were crowded out from them by the state once the crisis hit the country. Having already high levels of bankruptcy risk, they could not borrow any more from foreign sources over those years. Many of them sold out or went bankrupt. Not having shareholders in the domestic financial market assuring them support during bad times, even business groups that expanded and got highly indebted due to privatizations in the 1990's fared badly faced to the shocks produced by the international financial crises at the end of the same decade.

Table 4. Equity Holdings in Business Groups in Hands of the State in Brazil, 1998-2002

Business Group	Listed Firms	Performance	Equity in Hands of State Related Institutions (%)						
			1990-2003	1998	1999	2000	2001	2002	2003
Andrade Gutierrez	A.Gutierrez Concessoes	expansion	no						
Antarctica	Antarctica	contraction	no						
Aracruz	Aracruz Celulose	moderate evolution	BNDES	12.6	12.6	12.6	12.6	12.6	12.6
Bamerindus	NA	contraction	NA						
Belgo Mineira	NA	contraction	NA						
Bradesco	Banco Bradesco	expansion	no						
Brasil Telecom	Brasil Telecom Par	emergence	Previ	5.4	NA	NA	5.4	5.2	NA
Camargo Correa	Sao Paulo Alpargatas	expansion	Previ	11.5	13.6	14.7	NA	14.7	14.7
CPFL Energia	CPFL Energia	emergence	Previ/BNDES	37.7	NA	NA	NA	38	NA
CR Almeida	Ecorodovias	expansion	no						
CSN - Vicunha	CSN	expansion	Previ/Valia/BNDES	33.2	30.4	29	10.3	12.1	NA
Denerge	NA	contraction	NA						
Embraer	Embraer	emergence	NA						
Gerdau	Gerdau SA	expansion	BNDES	3.6	3.5	1.7	2.4	2.4	3.9
Itamarati	NA	moderate evolution	NA						
Itausa	Banco Itau Holding	moderate evolution	no						
JBS Friboi	NA	expansion	NA						
Klabin	Klabin	moderate evolution	Previ/Petros/BNDES	NA	NA	53.3	0	0.1	0.1
Light	Light	emergence	NA						
Lojas Americanas	Lojas Americanas	moderate evolution	Previ	4.5	0.9	4.3	4.4	0	5.9
Mendes Junior	Mendes Junior	moderate evolution	no						
Neonergia	Coelba	emergence	Previ/521 Par	20	20		39.6	39.6	40
Norquisa / Copene	NA	contraction	NA						
Odebrecht	Braskem	expansion	Previ/Petros	11.7	11.7	11.7	11.7	NA	1.6
Oi	Telemar Norte Leste Par	emergence	Previ	5.7	NA	1	2.3	2.3	2.2
Pao de Acucar	Cia Br. Distribucao	moderate evolution	no						
Perdigao	BRF Foods	expansion	Previ /Valia/Sistel/BNDES	52.2	48.8	47.2	47.1	48	48.5
Real	Real Holding	contraction	Previ	10.5	0	0	0	NA	NA
Sadia	Sadia	expansion	no						
Santista	Santista Alimentos	contraction	Previ	11.9	10.7	11.2	NA	NA	NA
Sul America	Sul America	contraction	no						
Suzano	Suzano Papel	expansion	Previ	12.9	0	0	0	0	0
TAM	TAM	moderate evolution	no						
Ultra	Ultrapar	expansion	no						
Unibanco	Uniao Bancos Br	moderate evolution	no						
Usiminas	Usiminas	emergence	Previ	NA	12.5	12.5	12.5	12.5	12.5
Vale	Vale do Rio Doce	emergence	BNDES/Valepar/Litel	43.7	44.6	45.9	45.9	34.8	34.8
Votorantim	Cim Itau	expansion	no						

Source: Author based on Economatica Database, accessed on March 22nd 2013.

Table 5. Equity Holdings in Business Groups in Hands of Pension Funds in Chile, 1998-2002

Business Group	Listed Firms	Business Group's Performance	Equity in Hands of Pension Funds 1998	1999	2000	2001	2002	2003
Angelini	Copec	expansion	3.4 (3 PF)	4.9 (4 PF)	5.5 (4 PF)	5.7 (4 PF)	6.6 (4 PF)	5.2 (2 PF)
Calderon	Ripley	moderate evolution						
CAP	Invercap	expansion	2.6 (1 PF)	2.6 (1 PF)	2.6 (1 PF)	1.3 (1 PF)	0	0
Claro	Elecmetal	expansion	0	3 (2 PF)	6 (2 PF)	1.5 (2 PF)	4.8 (1 PF)	3.7 (1 PF)
Fernandez Leon	Entel	expansion	0	0.3 (1 PF)	8.7 (4 PF)	4.4 (4 PF)	12 (7 PF)	21 (7 PF)
Hurtano Vicuna	Entel	expansion	0	0.3 (1 PF)	8.7 (4 PF)	4.4 (4 PF)	12 (7 PF)	21 (7 PF)
Ibanez	D&S	expansion						
Larrain Vial	CIC	expansion	0	0	0	0	0	0
Luksic	Madeco	expansion	0	4.5 (5 PF)	7.2 (5 PF)	10 (5 PF)	2.75 (2 PF)	2.9 (2 PF)
Marin Del Real	CGE	expansion						
Matte	Bicecorp	expansion	0	0	0	0	0.1 (1 PF)	0.2 (1 PF)
Paulmann	Almacenes Paris	expansion	0	0	2.1 (5 PF)	0	6.2 (6 PF)	21.2 (6 PF)
Penta	Penta	expansion						
Ponce	SQM	expansion	23.5 (7 PF)	26.8 (5 PF)	27.2 (6 PF)	9.1 (5 PF)	9.1 (5 PF)	11.25 (5 PF)
Said	Parque Arauco	expansion	0		3.6 (2 PF)	0	3.4 (1 PF)	3.8 (1 PF)
Saieh	Corp Group Banking	emergence						
Sigdo Koppers	Sigdo Koppers	expansion						
Solari-Cuneo-Del Rio	Falabella	expansion	0	0	0	0	1 (PF)	1 (PF)
Urenda	Empresas Navieras	expansion	12.5 (5 PF)	13.5 (5 PF)	13.4 (5 PF)	4 (5 PF)	4.5 (4 PF)	6.3 (4 PF)
Yarur	BCI	expansion	0	0	0	0	0	0

Source: Author based on Economatica, accessed March 22nd 2013.

Conclusion

Our purpose was to explain why business groups, expected to be unquestionable winners of market-oriented reforms, followed such different paths in Brazil, Chile, and Argentina during 1990-2003. We found that equity-financing policies explain better the patterns observed than the usual explanation of investor protection. In Brazil and Chile where the state provided equity financing directly (through public institutions in Brazil) or indirectly (through foreign owned pension funds in Chile), business groups fared well. Indeed, equity financing policies affected the governance structure of business groups in these countries enabling them to finance with equity from domestic sources without losing control on corporate decisions while keeping the level of bankruptcy risk under control in face of negative external financial shocks. In Argentina, pyramidal business groups despite the potential benefits of equity financing were mainly financed with foreign credit and fared badly. They were highly indebted in foreign currency and crowded out by the State from financial resources in face of negative external financial shocks.

This research offers a corollary on the financial relations between business groups and the state in the three countries and period studied. In Brazil, business groups - state relations were mostly cooperative and the state was a (minority) partner of business groups. In Chile, business groups - government relations were also mostly cooperative and the state was an arbitrator between domestic industrial business groups and foreign financial business groups operating in Chile. In Argentina, business groups - government relations were mainly competitive and the state was a rival of business groups in terms of financing. The reasons behind these relationships are an avenue for further research.

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[i] The *Banco Nacional de Desenvolvimento Economico* y Social is the Brazilian development bank.
[ii] This approach argues that corporate governance systems reflects the politics behind public policies, in contrast to the investor protection perspective that deals with conflict between shareholders separate from politics.
[iii] BNDES is a non deposit-taking institution, but it is by far the main provider of investment finance in Brazil. It has played a pivotal role in directed credit since its founding in 1951. "It currently provides around 60 percent of the country's long term finance … BNDES lent nearly $14 billion in 2004, which is far more than the Inter-American Development Bank lent in all of Latin America and approaches the amund that the World Bank lent in the entire world" (Stallings 2006, 233, 247).
[iv] BNDESPAR is a subsidiary of BNDES.
[v] The Brazilian State held equity of large firms since the 1970's (Lazzarini et al 2011).
[vi] The subsidized Federal Long Term Interest Rate (TJLP) was 7.5% points below the market rate (Lazzarini et al 2011, 6).
[vii] It traded stocks equivalent to 85% of GDP in 2002 (World Bank. 2004, 3).