

BROAD STOCK OWNERSHIP: THE HURDLE FOR MINORITY SHAREHOLDER RIGHTS DEVELOPMENT IN LATIN AMERICA

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ABSTRACT

Corporate governance reform has taken center stage in Latin America. Due to weak investor protection laws, Latin America has suffered decreased liquidity in its securities markets and this poses a troubling situation for these economies. The question is how can Latin American countries, as civil law systems, effectively incorporate shareholder protection rules in their legal systems. The existing theories do not address the barrier the civil law imposes as a majoritarian system on the development of minority shareholder rights. For Latin America to effectively address improved minority shareholder rights policies that promote broad stock ownership need to be implemented in conjunction with corporate governance reform.

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Chile is offered as the proper model for this type of reform contrasted with Mexico as an example of the status quo.

I. INTRODUCTION

Latin America is currently facing a credibility crisis among international investors. Well-publicized scandals describing majority shareholder abuses have caused international investors to slowly withdraw from Latin American securities markets.¹ The Asian financial crisis of 1997, largely induced by poor corporate governance and corruption, drew attention to the status of emerging market corporate governance.² Corporate governance is defined as “the private and public institutions, including laws, regulations and accepted business practices, which together govern the relationship, in a market economy, between corporate managers and entrepreneurs . . . on one hand, and those who invest resources in corporations, on the other.”³ Well-developed capital markets are engines for future economic growth.⁴ They are also an important source of foreign exchange capital for Latin American economies. The destabilizing effect of decreased portfolio investment has motivated Latin American countries to reassess their corporate governance laws and improve minority shareholder protection in particular.

Part II of this paper gives a background sketch of the situation. The main argument of the paper is that civil law in Latin America establishes an obstacle to the creation and adequate enforcement of minority shareholder laws. The existing theories of corporate ownership structure do not take into account a legal system’s structural inability to recognize these rights in Latin America. Recognition of the structural problem is necessary if a country decides to adjust its corporate governance laws to reflect adequate shareholder protection. The civil law operates on a majoritarian basis. Therefore, greater shareholder ownership across society is a necessary condition for the civil law society to demonstrate the political will necessary to create shareholder laws and adequately enforce them.

To understand how minority shareholder rights relate to corporate governance and securities market development, it is useful to understand some theory. Part III of this paper discusses the theories of corporate ownership and the

1. Mike Lubrano, *Corporate Governance: An International and Mexican Perspective*, 9 U.S.-MEX. L.J. 117, 117-18 (2001).

2. Joseph J. Norton, *Are Latin America and East Asia an Ocean Apart? The Connecting Currents of Asian Financial Crises*, 4 NATA: L. & BUS. REV. AM. 93, 100-06 (1998).

3. Charles P. Oman, *Corporate Governance and National Development*, at 13, ORG. FOR ECON. CO-OPERATION AND (OECD), DEV. CTR., Tech. Papers No. 180, CD/DOC-(2001)-12 (Nov. 21, 2001), available at <http://www.oecd.org/dataoecd/19/61/2432585.pdf> (last visited July 17, 2004) [hereinafter OECD].

4. Raghuram G. Rajan & Luigi Zingales, *Financial Dependence and Growth*, 88 AM. ECON. REV. 559, 584 (1998).

empirical support that gives the legal theory validity over the economic efficiency and path dependence theories. Part IV expands the legal theory to explain why a legal system's structural inability to develop corporate governance norms needs to be included in the calculus that explains how law shapes corporate governance. The argument is restated that a Latin American civil law country needs to promote broad distribution of stock ownership across society for minority shareholder rights to have a meaningful impact. Part V addresses the forces leading to greater convergence of corporate governance norms in Latin America. Part VI analyzes the development of minority shareholder rights in Chile and Mexico. Part VII concludes the paper.

II. BACKGROUND

In 1932, Adolph Berle and Gardiner Means introduced their theory of corporations in *The Modern Corporation and Private Property*.⁵ The Berle-Means model describes corporations owned by shareholders but controlled by a board of directors and professional managers, both with small ownership stakes in the company.⁶ The Berle-Means model attributes the separation of corporate ownership and control to dispersed stock ownership.⁷ A comparative study reveals most corporations (public and private) throughout the world do not follow the Berle-Means model of dispersed ownership, i.e. most companies have a majority shareholder usually comprised of a family group or the state.⁸

Three theories of corporate ownership structure are the efficiency, path dependence and legal theories. The three theories are treated more extensively below. Each theory has a unique perspective on another relevant and widely discussed topic: to what extent are corporate governance norms like firm ownership structure converging due to globalization. Empirical data supports the legal theory. Adherents to the legal theory argue dispersed corporate ownership is due to legal recognition and enforcement of minority shareholder rights.⁹

According to the OECD Principles of Corporate Governance, adequate protection of minority shareholder rights is an important aspect of corporate governance:

Investors' confidence that the capital they provide will be protected from misuse or misappropriation by corporate managers, board

5. Rafael La Porta et al., *Corporate Ownership Around The World*, at 2 (1998), at <http://post.economics.harvard.edu/faculty/shleifer/papers/ownership.pdf> (last visited July 17, 2004).

6. *Id.*

7. John C. Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. U.L. REV. 641 (1999).

8. La Porta et al., *supra* note 5, at 5.

9. *Id.* at 28, 33.

members or controlling shareholders is an important factor in the capital markets. Corporate boards, managers and controlling shareholders may have the opportunity to engage in activities that may advance their own interests at the expense of non-controlling shareholders. The Principles support equal treatment for foreign and domestic shareholders in corporate governance.¹⁰

Research shows common law countries like the United States offer greater minority shareholder rights protection than civil law societies.¹¹ Surprisingly, there is often a lack of inquiry as to *why* the common law allows greater minority shareholder protection than the civil law. Without examining this question the legal theory cannot adequately explain how globalization will impact Latin American law, which determines corporate governance norms like firm ownership structure.

It is argued the common law is more flexible than the civil law and therefore more conducive to legal recognition of minority shareholder rights.¹² This paper accepts this proposition but argues unless stock ownership is widely dispersed within a Latin American civil law society the lack of legislative will to recognize shareholder rights prevents their formation and adequate enforcement.¹³ Lack of widespread stock ownership in Latin America is an initial and formidable constraint on:

- a) Creation of minority shareholder rights;
- b) An independent judiciary to enforce these laws;
- c) Adequate market monitors that litigate majority shareholder abuses; and
- d) A portion of the local bar that advocates minority shareholder rights.

The legal theory of corporate governance stresses law but recognizes that economic efficiency and path dependence influence development of minority shareholder rights.¹⁴ However, the legal theory does not consider the nature of a legal system's original *inability* to recognize the rights as a major constraining

10. *OECD Principles of Corporate Governance*, at 40, OECD (2004), at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> (last visited Aug. 31, 2004).

11. La Porta et al., *supra* note 5, at 28.

12. Thorsten Beck et al., *Law and Finance: Why Does Legal Origin Matter?*, at 3, The World Bank Group, World Bank Pol'y Research Working Paper No. 2904 (Oct. 2002), available at http://econ.worldbank.org/files/20663_wps2904.pdf (last visited July 17, 2004).

13. Widespread ownership does not necessarily mean majority ownership. There may be widespread ownership across society in the form of minority investments. The important aspect is that stock ownership is distributed widely throughout society even if accomplished through minority ownership stakes.

14. Coffee, *supra* note 7, at 647.

factor. This is where broad stock ownership is the crucial factor behind creation and adequate enforcement of minority shareholder rights in Latin America.

As globalization marches on civil law countries must inevitably choose whether to improve minority shareholder protection. A country may decide to harmonize its minority shareholder rights with international standards. If that is the case then policies that promote share ownership across society need to be implemented for the rights to be codified and adequately upheld.

Why might a country want to improve its minority shareholder laws? The legal theory argues dispersed corporate ownership is due to legal recognition and enforcement of minority shareholder rights.¹⁵ Dispersed corporate ownership provides liquid capital markets and companies with higher market valuations.¹⁶ Development of securities markets is correlated with future economic growth.¹⁷ So countries may want dispersed corporate ownership to develop better capital markets which create future economic growth. Also, international investors are increasingly reluctant to invest in countries with poor minority shareholder protection due to well-publicized abuses committed by majority shareholders.¹⁸ This last reason is partially behind the drastic decrease in liquidity of many Latin American securities markets.¹⁹ Thin securities markets means less foreign investment, an important capital source for emerging market economies. Institutional investors have joined the voices expressing concern over poor minority shareholder protection in Latin America.²⁰ Also, international organizations like the OECD advocate improvement of minority shareholder protection to increase foreign and domestic investment, which results in economic prosperity that benefits all classes of citizens.²¹ The OECD argues better corporate governance leads to a more equitable economic environment for all social classes thus making a *social* as well as economic argument in favor of improved corporate governance.

If leaders of a Latin American country want to improve their securities markets to promote future economic growth, how can they overcome the barrier the civil law structurally imposes against development of minority shareholder rights? The major impediment against creation and adequate enforcement of minority shareholder rights in a civil law society is lack of broad stock ownership among society. Complementary legal reforms that encourage

15. La Porta et al., *supra* note 5, at 33.

16. Coffee, *supra* note 7, at 648-49.

17. Raghram, *supra* note 4.

18. See generally Andrea Mandel-Campbell, *Mexican Entrepreneur in Peace Offering to Minorities*, FIN. TIMES, Oct. 12, 1999, at 38.

19. Lubrano, *supra* note 1.

20. Manuel R. Agosin & Ernesto Pastén, *Corporate Governance in Chile*, at 12, OECD (Mar. 27, 2001), at <http://www.oecd.org/dataoecd/9/61/2443457.pdf> (last visited July 17, 2004).

21. OECD, *supra* note 10, at 7.

increased stock ownership among society are necessary. The examples of Chile and Mexico will be presented to show differing approaches towards minority shareholder protection in Latin America.

Chile enacted reforms that increased share ownership across society through its privatization of pension fund administrators.²² Chilean society's increased stake in corporate governance matters helped propel legal reforms that harmonized Chilean corporate governance laws with international standards.²³ Private pension fund administrators developed into powerful market monitors with the economic incentives to check abuses committed by majority shareholders.²⁴ Enforcement institutions in Chile asserted independence through application of fairness based shareholder laws.²⁵ A portion of the Chilean bar will develop to litigate lawsuits initiated by minority shareholders. This last change will have repercussions within Chile's legal profession as relational networks become less valuable and meritocratic and the rule of law becomes increasingly important.

Mexico has not modified its pension system to increase stock ownership or enacted regulations to achieve this goal.²⁶ Consequently, securities ownership is not widely distributed across society. Predictably, the legislature has not been pressured by constituents to implement meaningful corporate governance reform and its existing laws in this area are outdated compared to international standards. In contrast to Chile, despite reported cases of majority shareholder abuses, the Mexican legislature does not feel compelled to reform corporate governance law. Mexico adopts the stance the market ought to discriminate against companies that do not adhere to adequate corporate governance norms.²⁷ Adequate market monitors have failed to develop as a result of continued concentrated ownership structures. Liquidity of the Mexican securities market has languished as foreign investors demand greater minority shareholder protection before investing.²⁸ The Mexican judiciary and regulatory institutions cannot assert independence without fairness-based laws. Finally, the Mexican bar cannot move away from the insider relational networks that characterize the legal profession in Mexico and Latin America in general.

22. Agosin, *supra* note 20, at 4.

23. Mike Lubrano, *The Legal and Regulatory Framework – A Comparative Overview*, at 5, OECD (Apr. 27, 2000), at <http://www.oecd.org/dataoecd/56/26/1921891.pdf> (last visited July 17, 2004).

24. Agosin, *supra* note 20, at 16-17.

25. Ricardo Escobar, *Corporate Governance in Chile: New Developments*, at 6, OECD (Mar. 2001), at <http://www.oecd.org/dataoecd/3/49/1823372.pdf> (last visited July 17, 2004).

26. See generally BARBARA E. KRITZER, SOCIAL SECURITY PRIVATIZATION IN LATIN AMERICA 31-32 (Soc. Sec. Bulletin Vol. 63 No. 2, 2000).

27. Antje Zaldivar Mueller, *Corporate Governance Assessment: Mexico*, 9 U.S.-MEX. L.J. 137, 151 (2001).

28. Lubrano, *supra* note 1, at 119.

III. THEORIES OF CORPORATE OWNERSHIP

The Berle-Means model of corporations owned by dispersed passive shareholders and controlled by professional managers is limited to a few rich common law countries, the United States among them.²⁹ Companies in Latin America typically exhibit concentrated ownership, i.e., ownership dominated by a majority shareholder. Researchers have sought to explain why few countries follow the Berle-Means model. The following theories have been advanced.

A. *The Efficiency Theory*

The efficiency theory views corporate ownership structure and corporate governance in general as a function of economic efficiency.³⁰ Put another way, companies adopt corporate governance norms that are economically efficient. The economic advantages of dispersed ownership are empirically demonstrated. Dispersed corporate ownership encourages liquid capital markets and results in companies with high market values.³¹ However, it is inconclusive whether dispersed ownership is better than concentrated ownership. Concentrated corporate ownership offers better direct monitoring of management and greater investment in long-term projects.³² What is considered the most efficient ownership model may also depend on the economic context. At one time, when the United States economy was less robust than Japan's, the Japanese corporate governance model was considered superior but since the Japanese economy has contracted, attention has focused on the American model.³³ Since the United States' economy has slowed, arguments favoring United States style corporate governance have less force. Also, recent high profile cases of corporate abuse such as Worldcom, Tyco and Enron weaken the argument that American corporate governance is the best model.

Different countries express different values. In Germany, the idea of codetermination permeates the corporate culture.³⁴ Through codetermination, employees by statute have substantial representation among the board of

29. La Porta et al., *supra* note 5, at 34.

30. See generally Harold Demsetz, *The Structure of Ownership and the Theory of the Firm*, 26 J.L. & ECON. 375 (1983); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 212-18 (Harvard Univ. Press 1991).

31. Coffee, *supra* note 7, at 649.

32. *Id.* at 648.

33. Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 331 (2001).

34. Helmut Kohl, *Corporate Governance: Path Dependence and German Corporate Law: Some Skeptical Remarks from the Sideline*, 5 COLUM. J. EUR. L. 189, 194-95 (1999).

directors.³⁵ This notion is anathema to the American view directors possess the bulk of corporate control as representatives of shareholders, the ultimate owners of the firm. Codetermination is an example of how a different culture weighs values differently with respect to corporate governance issues. Economic efficiency cannot adequately explain this phenomenon and does not factor into its analysis these important cultural norm differences.

The economic efficiency theory does not explain why common law countries tend to have better minority shareholder protection than civil law countries. If economic efficiency is the principal force behind corporate ownership then relative differences in economic efficiency among countries would dictate the degree of concentration of corporate ownership.

Though economic efficiency is not the sole factor that determines corporate structure, it plays an important role within the context of globalization. Countries that want to increase foreign investment, unlock higher domestic company valuations, and develop efficient securities markets as an engine for future economic growth, may prioritize economic efficiency and adjust domestic corporate governance laws to reflect this judgment. This is what happened in Chile as regulators placed heavy emphasis on the economic benefits of improved minority shareholder protection. Alternatively, a country may decide the corporate governance framework ought to adjust by itself and allow companies to voluntarily adopt corporate governance reform. This is currently the stance adopted by Mexico. In September 1999 Mexico's Securities and Exchange Commission equivalent, the *Cámara Nacional de Bolsa y Valores (C.N.B.V.)* promulgated a *non-binding* corporate governance practices code.³⁶

It is possible government leaders in cases like Mexico believe their existing corporate governance norms reflect values that are more important than pure efficiency concerns, e.g., concentrated ownership promotes investment in long-term development of employee human capital.³⁷ Dispersed ownership facilitates changes in corporate control through takeovers and may subordinate employee interests in the process. Dispersed corporate ownership with its complementary well-developed capital markets has created companies with short-term vision that seek to maximize short-term profits.³⁸ Or, it may be entrenched economic interests prevent the government from instituting needed corporate governance reforms. These examples illustrate economic efficiency cannot by itself explain or predict a country's corporate ownership structure.

35. Friedrich Kubler, *Corporate Governance: Comment: On Mark Roe, German Codetermination and German Securities Market*, 5 COLUM. J. EUR. L. 213, 215-16 (1999).

36. Mueller, *supra* note 27, at 150.

37. Coffee, *supra* note 7, at 649.

38. *Id.* at 643.

B. Path Dependence

Adherents of path dependence believe corporate structure is principally influenced by politics and history.³⁹ Path dependence is the idea that “[i]nitial conditions, determined by the accident of history or the design of politics, can set an economy down a particular path.”⁴⁰ An example of path dependence in America is the theory that populist distrust of large financial intermediaries prompted laws that prevent these groups from amassing control of enterprises.⁴¹ Another example of what might be argued is path dependence is Japan with its lifetime employment as a result of post WWII policies.⁴²

In response to the legal theory, path dependence proponents argue law is dominated by politics and history, and adequate minority shareholder protection laws result from political policies that create a demand for these rights.⁴³ But even this argument does not eliminate the doubt cast on path dependence by the legal theory. The legal theory demonstrates there is a high correlation between minority shareholder rights protection and dispersed corporate ownership. If the path dependence theory is correct, all countries with similar corporate ownership models have similar political-historical forces shaping corporate ownership. That hypothesis would have us believe countries with mostly concentrated ownership like South Korea, Norway, Mexico and Greece share historical-political similarities that resulted in concentrated ownership.

The legal theory demonstrates common law countries tend to have better protection of minority shareholder rights than civil law countries. Path dependence, like the other theories, does not take into account the initial structural hurdle the civil law imposes on the development of minority shareholder rights, i.e., the civil law prevents formation of a political lobby that demands the rights and this is contingent upon broad stock ownership. Also, due to increased competition from globalization, many countries have begun adopting minority shareholder protection laws and this contravenes the idea corporate governance is mainly a function of history and politics.⁴⁴ Law matters but economic efficiency may trump path dependence as seen in countries like Chile.

Like economic efficiency, path dependence cannot by itself explain or predict a country's corporate ownership structure. However, like economic efficiency, path dependence is an important factor that may influence whether

39. *Id.* at 646.

40. Gilson, *supra* note 33, at 334.

41. *Id.*

42. *Id.*

43. *Id.* at 334-35.

44. Coffee, *supra* note 7, at 667.

a country adopts minority shareholder rights. An illustrative example of this is Japan. Post WWII Japan was heavily influenced by America. In 1950 due to strong political pressure from the United States, Japan enacted minority shareholder rights legislation.⁴⁵ This is an example of Japan, a civil law country, circumventing the hurdle initially presented by its legal system through politics and history to provide greater shareholder protection.

C. The Legal Theory

Proponents of the legal theory believe dispersed corporate ownership results from adequate legal protection of minority shareholder rights.⁴⁶ A study compared ownership structures of large and medium sized corporations in 27 countries and found that “except in economies with very good shareholder protection, relatively few of these firms are widely held, in contrast to the Berle-Means model of the modern corporation. Rather, these firms are typically controlled by families or the State.”⁴⁷ Adequate legal protection of minority shareholder rights allows controlling shareholders to reduce their ownership to a minority interest.⁴⁸ Without adequate legal protection a shareholder will amass a controlling stake to compensate for this lack of protection and minority shareholders invest because they are induced to buy at sharply discounted prices that reflect their inadequate legal protection.⁴⁹ The study also found a significant correlation among common law countries and adequate minority shareholder protection. The legal theory of corporate ownership structure has been described as an intermediate position between the opposing path dependence and economic efficiency theories.⁵⁰ Put another way, empirically it has been demonstrated law matters but economic efficiency and path dependence also influence corporate governance norms.

IV. THE LEGAL THEORY EXPANDED

The legal theory demonstrates minority shareholder protection is an important determinant of corporate ownership structure. Adequate minority shareholder protection leads to dispersed corporate ownership; inadequate minority shareholder protection leads to concentrated ownership. Common law countries afford better minority shareholder protection but this begs the question why?

45. Zenichi Shishido, *Japanese Law Symposium: Reform in Japanese Corporate Law and Corporate Governance: Current Changes in Historical Perspective*, 49 AM. J. COMP. L. 653, 653 (2001).

46. La Porta et al., *supra* note 5, at 35.

47. *Id.* at 19.

48. *Id.*

49. Coffee, *supra* note 7, at 644.

50. *Id.* at 647.

Research shows when compared to the civil law, the common law is better adapted to respond to evolving economic conditions.⁵¹ In civil law countries, judges play a mechanical role and because of this, the law may not suitably adapt to rapidly changing economic situations.⁵² Also, in the civil law codes are enacted on a majoritarian basis by the legislature. For minority shareholder rights to pass the legislature a base of shareholders large enough to elicit attention from the lawmaking body needs to exist *a priori*. Broad stock ownership among society is necessary for this reform to coalesce. Thus, due to the inflexibility to craft law that suits evolving economic needs and the *a priori* requirement of broad stock ownership the civil law acts as an initial constraint on the development of minority shareholder rights.

The majoritarian nature of the civil law requires politics to play a central role in shaping minority shareholder rights. It is incorrect, however, to conclude that because politics plays an important role in the development of minority shareholder rights this proves the validity of path dependence over all other theories. Instead, it should be recognized that due to the majoritarian nature of the civil law politics is necessary in this system to a greater degree than the common law. As the legal theory predicts, without minority shareholder rights developed through the mechanics of the civil law, liquid capital markets and dispersed ownership will flounder. The legal theory allows path dependence and economic efficiency to influence the outcome and this is an example where all three theories converge to influence the result.

The government of a civil law country may act as trustee of the public good and enact minority shareholder rights without broad stock ownership. However, without broad stock ownership there will be less legislative and institutional commitment to ensure enforcement of minority shareholder laws and an absence of market monitors. If a country improves its corporate governance code to reflect higher international fairness standards without increasing stock ownership the result will be formal adoption of laws largely devoid of substance. Without broad stock ownership the civil law framework will not recognize minority shareholder laws as a proper complement to other existing laws.⁵³ Formal adoption of minority shareholder laws without broad stock ownership would prevent development of essential elements to support the laws: political will, an independent judiciary, market monitors, and a portion of the bar that litigates majority shareholder abuses.

One might ask if broad stock ownership is conducive to minority shareholder reform why did Russia fare so badly? Russia went through a wave

51. Beck et al., *supra* note 12.

52. *Id.*

53. See Coffee *supra* note 7, at 659.

of “mass privatization” in 1992-1994.⁵⁴ As part of its privatization program Russia engaged in a mass voucher privatization program.⁵⁵ The Russian government gave citizens vouchers that could be exchanged for shares in companies that were being privatized.⁵⁶ However, most of the shares in these companies were awarded to managers and employees and on average twenty percent of a company was transferred to citizens.⁵⁷

Managers were intent on extracting as much gain from the company for personal use as possible and quickly purchased vouchers using illegally obtained funds to do so.⁵⁸ As majority shareholders, managers engaged in operations to extract company wealth to the detriment of minority shareholders.⁵⁹ Minority shareholder reform did not follow broad stock ownership because managers exploited rampant government corruption and Russia’s inexperience with corporate law.⁶⁰ Due to extensive corruption, the government was not prepared to protect the interests of minority shareholders.

Minority investors in Latin America are exposed to corruption and majority shareholders who have the opportunity to extract wealth from companies. However, unlike Russia, Latin America did not emerge from communism to a shock treatment of capitalism. Majority shareholders in Latin America had to establish a good reputation among minority shareholders to induce them to remain investors.⁶¹ This may seem like an argument in favor of the status quo in Latin America. However, because Latin American securities markets are languishing, many governments in the region are aware the time is ripe for corporate governance reform.

V. WHY IS CORPORATE GOVERNANCE CONVERGING?

The Global Corporate Governance Forum (GCGF) is an international initiative launched by the OECD and World Bank in collaboration with regulators and private sector leaders to help developing countries improve corporate governance.⁶² According to the GCGF:

54. Bernard Black et al., *Russian Privatization and Corporate Governance: What Went Wrong?*, 52 STAN. L. REV. 1731, 1739 (2000).

55. *Id.* at 1740.

56. *Id.*

57. *Id.*

58. *Id.*

59. Black et al., *supra* note 54, at 1734-35.

60. *Id.* at 1741-42.

61. *Id.*

62. *Corporate Governance: An Issue of International Concern*, at 2, GLOBAL CORPORATE GOVERNANCE FORUM (GCGF), at <http://www.gcgf.org/ABOUT.HTM> (last visited July 17, 2004) [hereinafter GCGF].

Corporate governance was lent new urgency by the global financial crises, which unleashed unprecedented volatility in markets, led to devaluation, default and capital flight, with the brunt borne by the poor. Reform on governance can no longer be viewed as a national or local issue for any corporation: globalization has brought in its wake the need for international coordination of effort to ensure that growth is sustained and shared: sustained in that it is robust and can withstand shocks—and shared in that it brings prosperity to the many, rather than the few. Good governance is a source of competitive advantage and critical to economic and social progress. In an increasingly globalized economy, firms need to tap domestic and international capital markets for investment. But capital providers have a choice—and the quality of corporate governance is increasingly becoming a criterion for investment and lending. Expanding and deepening the capital pool for developing and transition economies requires full attention to corporate governance standards. This sets the imperative for reform.⁶³

One reason Latin American countries want to improve minority shareholder protection is dispersed corporate ownership leads to developed capital markets and companies with high market capitalizations.⁶⁴ A developed securities market is correlated with future economic growth.⁶⁵ A country with concentrated corporate ownership may want to adopt minority shareholder rights to increase dispersed ownership and reap the benefits of developed capital markets. One of the stated goals of Chile's updated corporate governance laws was to provide "incentives for the dispersal of corporate ownership, thus encouraging current controllers to maintain control at lower levels of ownership concentration"⁶⁶ Companies with concentrated ownership may be benefited by a change in corporate ownership structure. Companies in developed securities markets have higher company valuations that facilitate global-scale acquisitions through higher stock prices.⁶⁷

The decreasing liquidity of Latin American securities markets is a serious problem for these countries.⁶⁸ Thinning trading volume is attributed to many factors like migration to foreign securities markets, reduced foreign investment, less initial public offerings, acquisitions by foreign firms, and de-listings due to

63. *Id.*

64. Coffee, *supra* note 7, at 659.

65. Rajan, *supra* note 4, at 584.

66. Jorge Bustos Oyanedel, *Tender Offers: The Chilean Case*, at 5, OECD (Apr. 2000), at <http://www.oecd.org/dataoecd/49/37/1930036.pdf> (last visited July 17, 2004).

67. Coffee, *supra* note 7, at 647.

68. Lubrano, *supra* note 1.

growing private transactions.⁶⁹ An important factor behind the reduced portfolio investment is weak minority shareholder protection.⁷⁰ Latin American countries have taken note of the decreased trading volumes and recognize the need to address investors' concerns regarding improved shareholder protection.⁷¹

Institutional investors advocate improved corporate governance in Latin America.⁷² The GCGF has a Private Sector Advisory Group (PSAG) that brings international private sector leaders to assist developing countries improve corporate governance.⁷³ To achieve its goals the PSAG established an Investor Responsibility Task Force that includes the world's largest institutional investors.⁷⁴ Together these investors manage \$3 trillion USD in assets.⁷⁵ One study conducted a survey of over 200 institutional investors who manage nearly \$3.25 trillion USD in assets. Seventy five percent of these investors consider corporate governance to be *at least* as important as financial performance when they consider whether to invest in a company.⁷⁶

International organizations like the OECD urge countries to improve corporate governance. According to the OECD *Principles of Corporate Governance (Principles)*, adequate protection of minority shareholder rights is an important aspect of corporate governance. The OECD *Principles* "represent a common basis that OECD Member countries consider essential for the development of good governance practice."⁷⁷ Section II of the *Principles: The Equitable Treatment of Shareholders* states "[t]he corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights."⁷⁸ Section II of the *Principles* lists the following as necessary elements for equitable treatment of shareholders: "All shareholders of the same class should be treated equally . . . [i]nsider trading and abusive self-dealing should be prohibited . . . [m]embers of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation."⁷⁹

69. *Id.*

70. *Id.* at 119.

71. *Id.* at 123.

72. Agosin, *supra* note 20, at 12.

73. *Private Sector Advisory Group*, at 1, GCGF, at <http://www.gcgf.org/partners/psag.htm> (last visited July 17, 2004) [hereinafter PSAG].

74. *Id.*

75. *Id.* at 2.

76. MCKINSEY & CO., INVESTOR OPINION SURVEY ON CORPORATE GOVERNANCE, at 1, GCGF (2000), at <http://www.gcgf.org/docs/72CGBrochure.PDF> (last visited July 17, 2004).

77. OECD, *supra* note 10, at 11.

78. *Id.* at 19.

79. *Id.*

VI. THE STATUS OF MINORITY SHAREHOLDER RIGHTS DEVELOPMENT IN CHILE AND MEXICO

A. Chile

Chile is presented as the case of strong convergence. In 1981, Chile reformed its pension system and allowed private firms called AFP's to administer pensions and invest in Chilean securities.⁸⁰ Under the new rules, *all* Chilean workers are obligated to contribute ten percent of their monthly incomes to the AFP, which invest in Chilean securities and AFP's now manage funds worth almost fifty percent of the country's GDP.⁸¹

Increased securities ownership across Chilean society helped create a political lobby that demanded improved minority shareholder protection after cases of majority shareholder abuse that "engendered shareholder rebellion, public outcry and eventually legislative responses."⁸² In 1981, Chile revamped its corporate law and in 2000, a new law on tender offers and corporate governance was passed (OPA Law).⁸³ The OPA Law is a bold attempt to bring Chilean corporate governance to international standards and "improve fairness, transparency and order in the Chilean Capital Market as a whole."⁸⁴

The OPA Law harmonizes Chilean corporate governance with OECD *Principles*, since the law requires equal treatment of shareholders in tender offers, incorporates stricter rules regarding use of confidential information, and forbids related transactions unless they have been approved by the board of directors and are consistent with standards of fairness.⁸⁵ Significantly, the OPA Law allows minority shareholders who own five percent of shares to bring a derivative suit against corporate insiders for violating Chilean Corporations Law, regulations or company bylaws.⁸⁶ A derivative suit allows a shareholder to sue individual corporate insiders on behalf of the corporation.⁸⁷ The OPA Law also stipulates litigation costs are paid by the defendant if the suit succeeds; otherwise, plaintiff bears the cost.⁸⁸ This policy encourages meritorious

80. Agosin, *supra* note 20, at 2.

81. *Id.* at 4.

82. Lubrano, *supra* note 23, at 5.

83. Jose W. Fernandez, *Corporate Caveat Emptor: Minority Shareholder Rights in Mexico, Chile, Brazil, Venezuela, and Argentina*, 32 U. MIAMI INTER-AM. L. REV. 157, 174 (2001).

84. Escobar, *supra* note 25, at 2.

85. *Id.* at 6-12.

86. *Id.* at 9.

87. *Id.*

88. *Id.*

lawsuits. To date Chile is the only Latin American country to introduce the concept of shareholder derivative suits.⁸⁹

The creation of AFP's (private pension fund managers) is an important reason for the comparatively good development of the Chilean securities markets.⁹⁰ As minority shareholders, AFP's are powerful monitors of abuses committed by majority shareholders.⁹¹ A high profile example of litigation initiated by AFP's as minority shareholders is the Chispas case.⁹²

The Chispas case arose when the Spanish acquirers of Enersis, Chile's largest electric utility holding company, bestowed inordinate benefits on Enersis' majority shareholder, a Chilean company called Chispas.⁹³ During the acquisition, the Spanish acquirer offered Chispas 840 times the price paid to minority shareholders, AFP's among them.⁹⁴ The AFP's sued in court to prevent the acquisition from occurring and succeeded to void the tender offer under minority shareholder laws.⁹⁵

Chile's legal profession, as most of the Latin American legal profession is an insider system heavily reliant on relational networks.⁹⁶ As part of a study, a person within the Mexican legal profession recognized the importance of relational networks for a young Mexican attorney:

I believe that human relations are always important in every sense. They are necessary because the young lawyer who is starting professional practice and has no social relations that can provide him or her with a case will have no work and will end up in small-time jobs, perhaps as the last secretary of a tribunal, or checking papers in a public office, and that's where he or she will remain⁹⁷

Another trait of the Latin American legal profession attributed to insider networks is weakness of the judiciary.⁹⁸ One study found that "[t]he major

89. Fernandez, *supra* note 83, at 180.

90. Agosin, *supra* note 20, at 4.

91. *Id.* at 14-17.

92. *Id.* at 16-17.

93. *Id.*

94. *Id.* at 17.

95. Agosin, *supra* note 20, at 18.

96. Larissa Adler Lomnitz & Rodrigo Salazar, *Cultural Elements in the Practice of Law in Mexico: Informal Networks in a Formal System*, in GLOBAL PRESCRIPTIONS: THE PRODUCTION, EXPORTATION, AND IMPORTATION OF A NEW LEGAL ORTHODOXY 210 (Yves Dezalay & Bryant G. Garth eds., Univ. of Mich. Press 2002).

97. *Id.* at 233.

98. YVES DEZALAY & BRIANT G. GARTH, *THE INTERNATIONALIZATION OF PALACE WARS: LAWYERS, ECONOMISTS, AND THE CONTEST TO TRANSFORM LATIN AMERICAN STATES (THE CHICAGO SERIES IN LAW AND SOCIETY)* 225 (Univ. of Chicago Press 2002).

structural weakness of the courts, as just described, was their dependency. They have historically been linked to extended families in Brazil and Chile and to the long-dominant political party in Mexico.⁹⁹

The legal profession in Chile will improve with the introduction of laws that level the playing field for minority shareholders. The derivative suit and provision awarding legal fees to the plaintiff if successful encourage plaintiffs' suits against powerful corporate insiders. The majority shareholders challenged in Chilean courts represent some of the most powerful interests in Latin America. It bodes well the legal profession in Chile has a framework for holding powerful economic groups accountable and has had success doing so. Holding majority shareholders accountable is an important step to improve corporate governance and signals a shift towards the rule of law.¹⁰⁰

It is important the Chilean OPA Law has as a goal to "improve fairness."¹⁰¹ Better minority shareholder protection is ultimately concerned with fairness to all shareholders. The enforcement of fairness-based rules will impact Chile's legal profession. According to one commentator Chile's Superintendence of Securities and Insurance (SVS) has a prominent role as enforcer of the OPA Law: "SVS plays a strong and active role to assure the strict observance of the new rules . . ."¹⁰² Independent government institutions like the SVS that apply the law and effective monitors like AFP's that litigate wrongs committed by powerful groups will increasingly interact to promote the rule of law over cronyism in Chile. A legal profession supported by independent institutions and adequate laws that punish abuses by powerful interests relies less on insider networks since the networks seek to protect entrenched interests. The ability to obtain legal redress from the most powerful interests in society implies reliance on the rule of law.¹⁰³

A legal system based on the rule of law values meritocracy and advocacy over personal networks. One can envision a portion of the Chilean bar that focuses on minority shareholder cases. This portion of the bar would be less inclined to develop relational capital as its top priority. Instead, it would rely on skill as long as adequate laws and independent institutions are in place. This entrepreneurial segment of the bar would value talent over personal relations and a legal meritocracy would emerge within this portion of the bar.

Chile has previously spearheaded free market reforms later imitated throughout Latin America.¹⁰⁴ Broad stock ownership, market monitors, fairness

99. *Id.*

100. *See* Lomnitz & Salazar, *supra* note 96, at 211.

101. Escobar, *supra* note 25, at 2.

102. *Id.* at 6.

103. *See* Lomnitz & Salazar, *supra* note 96, at 211.

104. *See Q&A: Chile's Socialist Leader is Betting on the New Economy (Extended)*, BUSINESSWEEK, Apr. 2, 2001, available at http://www.businessweek.com/magazine/content/01_14/b3726145.htm (last visited July 17, 2004).

based laws, an independent judiciary, and entrepreneurial meritocratic bar are crucial elements in Chile's move to update its corporate governance. Improved corporate governance may help the Latin American legal profession move away from insider relational networks to greater reliance on the rule of law. This can only reinforce the credibility of Latin America's commitment to minority shareholder rights and more equitable and transparent corporate governance in general.

B. Mexico

Mexico is presented as the case of weak convergence. In 1997 Mexico reformed its pension system, however it limited investment to government bonds.¹⁰⁵ As a result, widespread stock ownership has not occurred in Mexico. In September 1999 Mexico's Securities and Exchange Commission equivalent, the Cámara Nacional de Bolsa y Valores (CNBV) promulgated a *non-binding* corporate governance practices code.¹⁰⁶ The code strengthens minority shareholder protection and recommends formation of special committees of the board of directors.¹⁰⁷ Mexican law makes it mandatory for public companies to disclose their "level of adherence to the practices recommended by the Code."¹⁰⁸ This approach leaves the market to dictate the results, punishing companies that adhere least to the code.¹⁰⁹

Mexican law hinders litigation of majority shareholder abuses. An example of inadequate minority shareholder protection is Mexico's General Law of Commercial Companies (LGSM) Article 201:

[A]ny judicial challenge to corporate resolutions must be presented by the owners of at least one-third of the capital stock of the corporation, none of which may have voted in favor of the resolution in question. Owners of at least one-third of the capital stock may also bring an action on behalf of the corporation against its directors.¹¹⁰

Article 201 is not favorable to minority shareholders because its one-third ownership requirement is restrictively high. It has the potential to become a very useful law if the ownership threshold is lowered. Under the Chilean OPA Law a derivative suit may be brought by a shareholder who owns five percent of the stock, a level institutional investors can feasibly obtain. Article 201 allows what may resemble a derivative suit but the one-third ownership

105. Kritzer, *supra* note 26.

106. Mueller, *supra* note 27, at 150.

107. *Id.* at 151.

108. *Id.*

109. *Id.*

110. Fernandez, *supra* note 83, at 168.

requirement is so onerous it makes the law largely useless. One commentator observed that in Mexico:

shareholder rights and more specifically, the rights of minorities are very limited. There are no remedies in equity and Mexican courts have taken the position of enforcing form over substance. Litigation in Mexico is of limited value, and usually requires substantial expense. Cases are not reported, and the few decisions that are, reach the federal circuit courts and occasionally, the Supreme Court, where the particular facts are not reported, but simply a paragraph containing the principle upheld is published.¹¹¹

Is path dependence stronger in Mexico than in Chile? Path dependence proponents would claim Mexican political and historical forces trumped efficiency concerns. This may be true only to an extent because legal reform is not the only path towards convergence. Convergence may occur through indirect means, e.g., some large foreign corporations have migrated to United States' exchanges and subjected themselves to higher corporate governance standards.¹¹² Also, many Mexican companies have been acquired by foreign companies, which adhere to stricter corporate governance rules.¹¹³ However, the possibility exists that entrenched economic interests lobbied the Mexican government to refrain from instituting corporate governance reform that would benefit the economy as a whole. It is also possible Mexican regulators are unaware of the constraints the civil law places on the development of minority shareholder protection. If so, regulators are unaware reforms to disperse stock ownership are needed to develop and adequately enforce minority shareholder rights.

The absence of adequate minority shareholder reform in Mexico has resulted in *status quo*, e.g., a legal profession incapable of litigating abuses committed by majority shareholders. An example of unchecked majority abuse occurred in 1999. Ricardo Salinas Pliego is head of one of Mexico's largest industrial groups that includes Elektra, a large retailer, and TV Azteca, a broadcasting company.¹¹⁴ In 1999, Salinas sold half of his privately owned telephone

111. Mueller, *supra* note 27, at 143.

112. Coffee, *supra* note 7, at 650.

113. See Carlos Morales & Ileana Fernandez, "Telecom is King," *Latin American M & A Hits Record of \$90.252 bil with 1,199 Deals Announced, Brazil Leads the Pack with the Bust of Telefonica SA, Morgan Stanley Dean Witter-Overall Top Financial Adviser*, at 3, THOMSON FIN., Sec. Data, Latin American Research Group (2000), at <http://www.tfsd.com/league/pdfs/4Q2000/LatAm2000FinalPressRelease.PDF> (last visited July 17, 2004).

114. Mandel-Campbell, *supra* note 18.

company, Unefon, to TV Azteca after he was unable to obtain financing for a Unefon venture.¹¹⁵

TV Azteca's minority shareholders were angered since they were reluctant to assume ownership of an upstart telephone company.¹¹⁶ Under more equitable laws, minority shareholders would have litigated Mr. Salinas' actions as an abuse of power or breach of loyalty to the corporation. Mr. Salinas saw the publicly traded stocks he controls plummet in value as investors foresaw future abuses.¹¹⁷ Salinas sought to make peace with minority shareholders by reforming the corporate boards of Elektra and TV Azteca.¹¹⁸ However, the harm was done and nothing in the existing Mexican regulatory framework can prevent another such abuse of power.

Under the existing environment, the Mexican legal profession will retain the image and characteristics of an insider network. As long as the Mexican legal profession is unable to place checks on powerful interests within society the legal profession will serve the needs of those whose power remains unchecked. If powerful interests are held unaccountable, the legal profession has little incentive to move away from a model of insider networks.

Adequate minority shareholder protection requires independent institutions to enforce the law objectively. Without broader stock ownership in a civil law society there will be inadequate legislative will to create minority shareholder laws and inadequate will to maintain the independent institutions that enforce these laws. Under the *status quo*, the lack of independent institutions may be viewed as a major problem in the Mexican and Latin American legal profession.

Mexico and other Latin American countries may be slow to follow Chile's lead due to path dependence or lack of awareness that the civil law creates a constraint on the development of minority shareholder laws. However, if Chile's corporate governance reform creates a more transparent legal system that attracts investment, Mexico and other Latin American countries will be inclined to follow Chile's lead to retain a competitive advantage. Globalization requires countries to maintain competitive advantages and law can help them achieve this goal.

VII. CONCLUSION

Globalization creates the need for corporate governance reform, particularly the improvement of minority shareholder rights. Corporate governance reform is intended to improve the local economy and securities markets. Globalization accelerates the need for reform as developing countries seek

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

foreign investment and update their corporate governance codes to reflect international standards like the OECD *Principles*. Latin American securities markets have been languishing in part because the region has been slow to improve corporate governance.¹¹⁹

The situation is complicated since countries in Latin America follow the civil law tradition. Due to its inability to respond to economic changes and its majoritarian nature, the civil law is a formidable obstacle for minority shareholder rights development. None of the existing theories of corporate structure address this issue. Without broad stock ownership, the civil law is poorly equipped structurally to address corporate governance reforms. Broad stock ownership solidifies the legislative will to create minority shareholder laws and through fairness-based laws helps the judiciary assert independence as it enforces these laws. Broad stock ownership also gives rise to monitors that litigate abuses committed by majority shareholders. With the appropriate laws and institutions in place, the Latin American legal profession can move away from its traditional insider network structure to one that is more reliant on information and meritocracy.

Chile implemented reforms that increased stock ownership among society and this created the political will to develop adequate minority shareholder protection laws. Applying fairness-based laws helped the judiciary assert its independence. The fairness component of the Chilean OPA Law and independent regulatory institutions will help reduce cronyism in Chile.

Globalization has drawn attention to corporate governance and particularly minority shareholder rights in Latin America. For example, OECD's Latin American Corporate Governance Roundtable,

aims to facilitate public and private sector policy-dialogue. It provides a forum for the exchange of experiences between senior policy-makers, regulators and market participants with first hand experience of present developments and ongoing work. Building on its discussions, the Roundtable will issue a Latin American Corporate Governance White Paper. The White Paper will target the most urgent areas for improvement, propose effective ways to respond to existing shortcomings and discuss the appropriate division of responsibilities among different groupings. The conclusions made in the White Paper will serve as a practical reform agenda and also form valuable input to any future review of the OECD Principles of Corporate Governance. Participants to the Roundtable come from Argentina, Brazil, Chile, Colombia, the Czech Republic, France,

119. Lubrana, *supra* note 1, at 119-20.

Hungary, Mexico, Paraguay, Peru, Turkey, the United Kingdom, the United States and Venezuela.¹²⁰

Fairness based laws, independent institutions and a competent bar that litigates abuses committed by majority shareholders help foster the rule of law. If Chile's improved corporate governance code encourages economic prosperity, other Latin American nations will look towards Chile as a model for updating their own corporate governance codes. However, it should be stressed Chile's success is in large part due to broader stock ownership. This is the missing factor the literature has not focused on and explains why the civil law so often fails to provide adequate minority shareholder protection.

120. *The Latin American Corporate Governance Roundtable*, at 1, OECD, at http://www.oecd.org/document/63/0,2340,en_2649_37439_2048255_1_1_1_37439,00.html (last visited July 17, 2004).