Corporate Governance in Emerging Markets

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Abstract

The turning to the XXI century has been marked by reforms in corporate governance practices around the world. Whether due to shocks caused by the economic crisis in East Asia, Russia and Latin America, or by financial scandals in the United States and Europe, the fact is that the way of doing business has changed in terms of demands for greater corporate transparency and accountability, shifts in control of ownership, empowerment of new types of owners and so on. Consequently, countries and firms have adapted their corporate governance policies and practices to this new governance environment. In this chapter, we discuss the foundation of corporate governance, that is, corporate ownership. In particular, we explore the current patterns of the ownership structure of publicly listed firms in six emerging countries. To do so, we have collected firm ownership data for listed firms in Brazil, Chile, South Korea, Czech Republic, Hungary, and Poland during the first decade of the XXI century, and we compare our data with existing ownership research of these countries in the late 1990s. We conclude that although concentration of corporate shareholdings continues to be a common denominator among these emerging countries, the processes and structures controlling firms across countries is remarkably different. For instance, the privatization process in the 1990s, in spite of having different motivations and goals in Latin American and Eastern Europe shaped much of the corporate ownership transformations. Our chapter offers a comparative analysis of the corporate ownership changes in emerging markets.

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Abstract

The turning to the XXI century has been marked by reforms in corporate governance practices around the world. Whether due to shocks caused by the economic crisis in East Asia, Russia and Latin America, or by financial scandals in the United States and Europe, the fact is that the way of doing business has changed in terms of demands for greater corporate transparency and accountability, shifts in control of ownership, empowerment of new types of owners and so on. Consequently, countries and firms have adapted their corporate governance policies and practices to this new governance environment. In this chapter, we discuss the foundation of corporate governance, that is, corporate ownership. In particular, we explore the current patterns of the ownership structure of publicly listed firms in six emerging countries. To do so, we have collected firm ownership data for listed firms in Brazil, Chile, South Korea, Czech Republic, Hungary, and Poland during the first decade of the XXI century, and we compare our data with existing ownership research of these countries in the late 1990s. We conclude that although concentration of corporate shareholdings continues to be a common denominator among these emerging countries, the processes and structures controlling firms across countries is remarkably different. For instance, the privatization process in the 1990s, in spite of having different motivations and goals in Latin American and Eastern Europe shaped much of the corporate ownership transformations. Our chapter offers a comparative analysis of the corporate ownership changes in emerging markets.

Keywords: Corporate ownership, emerging markets, Brazil, Chile, South Korea, Czech Republic, Hungary, Poland, international corporate governance.

Introduction

An unresolved issue in the comparative corporate governance literature is to better understand cross-national differences in corporate ownership patterns (i.e., concentration/ dispersion and types of owners) and to what degree institutional factors shape these trends (Morgan, Campbell, Crouch, Pedersen, and Whitley, 2010; Aguilera and Jackson, 2003). While Berle and Means (1932) assumed the prevalence of widely held firms, the empirical literature reveals that a separation of ownership and control is the exception worldwide rather than the norm, particularly in emerging markets (Demsetz and Lehn 1985; La Porta, López-de-Silanes and Shleifer 1999; Pedersen and Thomsen 1999, 2000; Claessens, Djankov and Lang 2000; Becht and Mayer 2001; Franks and Mayer 2001; Faccio and Lang 2002; Franks, Mayer and Wagner 2006; Franks, Mayer and Rossi 2009). In this chapter, we offer an empirical analysis of ownership patterns in six countries spread across three emerging market regions, Latin America, Asia and Central and Eastern Europe (CEE).

Comparative corporate governance research has identified politics, law and economics as the main factors triggering different ownership patterns across countries (Gourevitch and Shinn 2005; Gilson 2006; Goyer 2010; Aguilera and Jackson 2010). Theories of capitalism and transition to capitalism encompass a complex set of forces ranging from global governance pressures (Morgan and Kristenen, forthcoming) to firms highly embedded in local political environments (Krug, forthcoming). Firms behave differently not only contingent on their institutional environment but also on their public/private dimension. We focus on publicly traded firms in emerging markets to control for some of the market heterogeneity of enterprises.

In particular, we would like to answer the basic question of *whether there have been significant changes in the patters of corporate ownership among publicly traded firms in emerging markets*. In order to address this question, we have built a corporate ownership dataset by collecting data from five different sources: Amadeus for CEE, Economatica and Osiris for Latin America, and TS-2000 and Korean Exchange Statistics (KRX) for Korea. Our data was complemented and crosschecked with annual reports when necessary. We take all publicly listed firms, including both financial and non-financial, from each country stock exchange and dropped firms where the ownership information was missing or data was unreliable.[1] Our full sample consists of 19,969 (16,024 Korea, 2,596 Brazil and Chile and 1,349 CEE) firm-year observations.

This unique and highly representative dataset allows us to contribute to the comparative corporate governance literature and to add to existing empirical research, particularly regarding the patterns of firm ownership in countries where capital markets are emerging, information asymmetry among shareholders is high and minority shareholders' legal protection is weak. This chapter also illustrates that emerging markets are very much characterized by their idiosyncratic national models of capitalism, each with their particular financial system as argued by Morgan and Goyer in this volume (forthcoming). In the next sections, we discuss the corporate ownership structures in countries from these three emerging regions.

Ownership Structure in Brazil and Chile

Understanding the institutional environment and the interconnections among economic actors in Latin American countries (hereafter, LAC) helps explain firm ownership control of corporations. Schneider (2004), in a study on collective action in Latin America, reports a wide variation in the organization of business in Latin America. Nevertheless, the high level of industry concentration is a common pattern across countries. As an example, in Mexico, by 1989, 37 members of the "Consejo Mexicano de Hombres de Negocio" (CMHN), controlled 70 major industrial conglomerates (*grupos*) that accounted for 22 percent of total

[1] For Czech Republic, 25 observations did not have ownership data and for Hungary, 65 observations did not have ownership data, and for Poland, 495 observations did not have ownership data. In Korea, 689 out of 16,713 observations do not provide ownership information and were excluded from the sample. In Brazil and Chile we have 2,596 of 3,205 firm-year observations, which represent 81% of the number of listed firms for the period between 2004 and 2008 and 93.46% of the market capitalization.

GDP. In Chile, eleven *grupos* had control or influence over 290 corporations that accounted for 70 percent of corporate capital in the fifties. Schneider also reports that, in 1983, the multinational corporations and state enterprises in Brazil, Argentina and Mexico accounted for ¾ or more of the total sales of 50 largest corporations.

State intervention and the high industry concentration were often the result of the import substitution model of development that Latin American countries followed between the 1930s and 1980s (Furtado 1982; Bullmer-Thomas 2001). Protected by a tariff wall and other entry barriers, many industries presented high rate of return on capital, favouring an oligopoly model and incentivizing both foreign and domestic capital investments. Such models drove high levels of concentration in the hands of multinational subsidiaries and state firms.

In the 1980s and 1990s, pressured by the "Washington Consensus"[2], Latin American countries undertook orthodox macro-economy policy reforms, which reduced many areas of state intervention in the economy and subjected most firms to greater competition (Kuczynski and Williamson 2003). Among a variety of policies, the one that had the greatest impact on the business organizational environment was the privatization process. Over different time periods and intensity, almost all Latin American countries have experienced a period of privatization. The trigger to the process was the aim to reduce government's debt levels as a way to signal good governance practices and to have access to financial support from Anglo-American financial institutions such as the IMF. Between 1988 and 1996, more than 900 companies were privatized in Latin America and accounted for 55 percent of total privatization revenues in the developing world in the 1990s (Serva 2003; Chong and López-

[2] Coined by John Williamson (1990) in the paper "What Washington means by policy reforms" where he identifies ten policy areas in which a fairly broad consensus might exist on what countries in Latin America and elsewhere should do: fiscal discipline, public expenditure priorities, tax reform, financial liberalization, exchange rates, trade liberalization, foreign direct investment, and privatization, deregulation, and property rights. The basic content of this agenda is summarized as macroeconomic prudence, outward orientation and domestic liberalization towards a free market model.

de-Silanes 2005)[3]. This process had a major effect on the reconfiguration of corporate ownership in Argentina, Brazil, Chile and Mexico. Another important outcome of the market-oriented reforms was the emergence of a new set of institutions to regulate privatized natural-monopolies sectors (i.e., water supply, oil, gas, telecommunications and transportation industries) and to improve market competition. It is described as the second-stage (or generation) reforms (Naím 1994; Kuczynski and Williamson 2003).

Despite all these efforts to increase economic stability and to develop financial markets, the most important firms continue to concentrate under the control of the business groups, *the Grupos.* Although there is very little comparative research on firm ownership in Latin America, Lefort (2005) using 1,010 firms from Argentina, Brazil, Chile, Colombia, Mexico and Peru in 2002 and Santiago-Castro and Brown (2007) studying 97 companies from Chile, Brazil, and Mexico from 2000 through 2002, show that family ownership and business group affiliation is a common pattern in these countries. Chong and López-de-Silanes (2007), following the legal family arguments from La Porta et al. (1999), claim that observed ownership concentration in Latin America is a consequence of inadequacies of the legal institutions supporting their hypothesis that countries without strong minority shareholder protection are not likely to have widely held firms. Next, we turn to an in-depth analysis of Brazil and Chile.

Brazil

Under the presidency of Itamar Franco, in 1994, the "Plano Real" was established. This is a milestone in the economic and institutional reform in the recent Brazilian history. The reduction of the annual inflation rate (2,708 percent in 1993 to 15 percent in 1995), macroeconomic uncertainty and volatility, together with the monetary stability, trade liberalization and privatization allowed the country to experience relative economic stability. In the first-generation of reforms, including the privatization process, the Brazilian

[3] Refer to Chong and López-de-Silanes (2005) for a deep study of the privatization process in Latin America.

government transferred its control of 119 firms to the private sector between the beginning of 1991 and July 2001 (Anuatti-Neto et al., 2005). The main sectors affected were electricity and telecommunications (which each accounted for 31 percent of the total value of the transactions). Some companies were not included in the privatization process at that time, either because of their strategic role for the government or due to other political and social pressures, notably the oil and gas Company, *Petrobrás,* and *Banco do Brasil*—the largest Brazilian bank, which plays an important role in financing agricultural sector and, therefore, enjoys strong political support. The second-generation of reforms, which included the creation of mechanisms to boost competitiveness in the private sector, foster employment and reduce the state intervention in the economy, were excluded from the Brazilian reform agenda (Fleury and Fleury 2009).

Nevertheless, reforms to increase investor confidence, and to expand, both domestic and foreign, investments have been carried out, resulting in some increase in market competition and liberalization of the financial markets. There are three illustrative examples. First, a new competition law was enacted in 1994 to introduce a merger and acquisitions control process and to reconfigure the Administrative Council for Economic Defence (CADE) into an independent agency. From 1994 to 1998, the pace of privatization process increased; the government agency responsible for general administration of prices was abolished, and new, independent regulatory agencies for telecommunications, petroleum and natural gas, and electricity were created (OECD/ IDB, 2006). And, in December 2000, a new law added important investigatory powers to CADE.

Second, regarding the capital markets, the Brazilian Securities Law (6.385/76) and Corporation Law (6.404/76) were amended in 2001 (10.303/2001) and, subsequently, in 2007 (11.638/2007) as a result of the Brazilian Corporation and Securities Laws reform. Among the main changes proposed by the new legislation, Lima Jr. (2001) emphasizes those affecting:

(1) separation between ownership and control, especially non-voting shares were capped at 50 percent of the capital stock for new companies and IPOs of non-listed companies, (2) dispute resolutions, (3) calling of shareholders' meetings, (4) composition of the board of directors, (5) regulation on independent auditors, and (6) regulation on insider's information and trading.

And third, the São Paulo Stock Exchange launched a self-regulation initiative in 2000, which defined different listing segments according to corporate governance practices. The more strict category called "*Novo Mercado*" established, among other things, that firms are allowed to issue only voting shares. Given all these efforts attempting to increase investor protection and confidence, and consequently, to increase the participation of households and small investors in the financial markets, have these reforms influenced on the distribution of corporate control across publicly listed firms?

We have collected data from 2004 to 2008 and also relied on previous literature on Brazilian corporate ownership to illustrate that, although much has been done at the institutional and country level to promote the financial market development and liquidity, the high levels of corporate ownership concentration across Brazilian listed firms persists as a common pattern. Leal and Carvalhal-da-Silva (2007), using a data set from the Brazilian Stock Exchange Commission (i.e., *Commisão de Valores Mobiliários*, CVM), report a median value of 69 percent of direct voting shares concentrated in the largest shareholder (87 percent for the three largest shareholders) and 66 percent voting rights when measuring the indirect ownership of ultimate owner (87 percent for the three largest shareholders) for 1998. In addition, they assess the ownership concentration over the period between 1998 and 2002 and report a uniform pattern towards high levels of concentration. Other empirical literature on ownership concentration reports similar results (Valadares and Leal 2000; Valadares 2002; Santiago-Castro and Brown 2007; Céspedes et al. 2010).

In Table 1, we show the direct shareholding concentration for the largest shareholder (C1) and the three largest shareholders (C3) respectively: 49.1 percent and 66.4 percent, on average, for the period 2004- 2008. Our data not only corroborates previous findings, which indicate that Brazilian firms have high levels of ownership concentration of control but also show that such pattern has not changed over time.

Insert Table 1 about here

Despite the initiatives to (1) boost the Brazilian capital markets into a more liquid market where households could have a role and the minority shareholders together could represent more than one single shareholder and (2) to foster major reductions on the levels of ownership concentration, the fact is that publicly listed firms continue to be highly concentrated in the hands of a small number of owners. This is in line with the argument that the average values of ownership concentration tend to be higher in countries with low institutional investor protection (La Porta et al. 1999; Bergström and Rydquist 1990).

In addition to examining patterns of ownership concentration, several scholars including Vitols (2002), Aguilera and Jackson (2003, 2010) and Adams et al. (2010), call for a distinction between different types of controlling shareholders when studying ownership structure because of their distinctive influence on firms' outcomes and behavior. Hence, we examine the characteristics of the majority shareholders. Table 2 reports the mean values of ownership concentration according to distinctive types of shareholders and their origin. Among the largest shareholders of our sample, the industrial firms are predominant, which, in average from 2004-2008, comprised 40.1 percent of shareholdings. The next in importance are the banks (with an average of 29.95 percent), followed by institutional investors (i.e. hedge and pension funds, insurance companies, etc.; 12.75 percent) and individuals and families (12.65 percent). Government participation is, in average, only 4.96 percent of our sample. Considering the sample period, we noticed a moderately decline on shares held by industrial firms (from 45.93 percent in 2004 to 34.04 percent in 2008, in average) where individuals and families, and government entities are the ultimate shareholders[4], while the relative share of banks and institutional investors rose from 35.32 percent to 47.69 percent. In addition, although foreign shareholders hold, in average 17.96 percent in 2004 and increase their participation to 28.22 percent in 2008 (see Table 1), the domestic shareholders are still the majority owners of direct shareholdings.

Insert Table 2 about here

The bottom line is that industrial firms are the most important player in the direct ownership of Brazilian firms and hold, in average, 40 percent of stocks. One explanation is that, in Brazil; the Securities Law allows companies to maintain and issue non-voting shares (i.e., preferred shares) and to have pyramidal schemes[5]. In fact, about 90 percent of trading volume at the Sao Paulo's Stock Exchange involves non-voting shares (Leal and Carvalhal-da-Silva 2007). Thus, not surprisingly, the direct shareholdings control is high and controlled by industrial groups who use preferred shares (e.g., nonvoting shares) to finance their projects. Also, previous studies (Aldrighi and Mazzer-Neto 2007; Aldrighi and Postali 2010) report that, on average, 54.4 percent of firms under the Stock Exchange Commission regulation had pyramidal arrangements in 2002 and, from those firms, 63.8 percent have families as the largest ultimate shareholders. This situation is characterized as an implicit contract between the controlling and minority shareholders where the controlling shareholder obtains cheap equity on the understanding that he holds a large equity fraction, thereby

[4] See discussion on pyramidal structures at the methodological part and refer to Aldrigui and Postali (2010) about Brazilian business groups.
[5] Pyramidal schemes mean that there is at least one firm between the firm and its ultimate shareholder (Aldrighi and Postali 2010).

making it credible that the value of the shares will be maximized (Bergström and Rydqvist 1990).

This ownership structure reflects to some extent the privatization strategy followed by the Brazilian Government in mid 1990's. In order to maximize the biding prices to the government's assets, they pushed for consortium coalitions where public entities, such as pension funds (Previ, Petros, Funcef), development and public banks (BNDES, Banco do Brasil, Caixa Econômica Federal) were the leading players to finance domestic private bidders.

Chile

In September 1973, Chile's annual inflation rate was 286 percent, the nominal average tariff for imports was 105 percent, and the fiscal deficit reached 20 percent of GDP (Buc, 2006). This situation led to a military dictatorship and to a new economic strategy. In 1974, Chile started a profound process of trade liberalization and institutional reforms. The first step was to reduce import tariffs for a flat 10percent in all products which was considered to be the pillar of economic transformations that came as consequences of the opening process. The institutional reforms included changes in the Chilean Constitution that affected directly capital markets. First, private property rights were guaranteed by the Constitution as the baseline to a favourable environment to investments. Second, they established the autonomy of the Central Bank that could define monetary policies without political interventions. And third, the Constitution restricted government spending, which required an approval by law. Besides that, in 1981 the reform of the pension fund system took place, where an individual capitalization account program was designed with specific contributions, administered by private institutions selected by the workers, the AFPs (i.e., *Administradoras de Fondo de Pension*).

The privatization of state-owned companies was also an important process intended to increase market competitiveness and reduce state intervention. In fact, Chile was the first Latin American country to implement a systematic privatization program. In the first wave of privatization, in the early 1970s, 257 companies were transferred to the private sector, many of them previously nationalized by Allende (Serva, 2003). In the 1980s, a second wave of privatization was undertaken, and in 1990s another 30 state enterprises had been fully privatized, including steel producing companies, utilities, telecommunications, mining and air carriers. During this period, pension funds had acquired about 25percent of the shares of privatized enterprises in open auctions (Baer, 1994).

In 1990, Pinochet stepped down and a center-left alliance, the *Concertación*, headed by Aylwin, became the first democratic government since Allende's. Despite the restoration of democracy and a decade of center-left government, during the 1990s there was more continuity than change in economic and labour policies (Winn, 2004:51). The most significant initiative was the historic agreement between the major labour organizations, so-called "Acuerdo Marco" where they explicitly recognized private enterprises as the principal and legitimate agent of economic growth (Frank, 2004). The center-left government legitimated and consolidated Pinochet's market-oriented policies, as it did with the opening of trade through multiple free trade agreements, the enhancement of the private social security system, and the privatization of utilities services, highways, and other public services.

However, neither Pinochet's nor the *Concertación*'s initiatives were enough to change the Chilean corporate ownership patterns that, at a first look, were characterized by highly concentrated ownership where industrial firms and institutional investors directly controlled most listed firms. Tables 1 and 2 illustrate this phenomenon where the largest shareholder controls, in average, 50.6 percent of shares and the sum of the three largest shareholders 69.2 percent, which is significantly above the ownership concentration of developed countries firms (Majluf, Abarca and Rodriguez 1998; Lefort 2005, 2010; Lefort and Urzua 2008). Taking our sample period (2004-2008), we observe that this pattern does not change significantly overtime and confirms prior empirical findings (Majluf et al. 1998; Lefort 2005).

Table 2 reports that industrial firms and institutional investors directly control firms, which together, account for 91.5 percent of shares. The privatization process coupled with regulatory reforms has influenced this ownership composition. Unlike in Brazil, where the main motivation to the privatization was to restore public finance while keeping the influence of the state through public pension funds and development banks, in Chile the privatization process was implemented partly with the purpose of achieving dispersed firm ownership and of developing the capital market. However, Chilean business groups rapidly took over most newly privatized firms, sometimes in association with foreign companies (Lefort 2010). In fact, industrial firms held, in average, 71.6 percent of listed firms between 2004 and 2008.

Chilean Corporate Law shaped the type of owners in at least two ways. First, the creation of AFP in 1981, established the ground for domestic and foreign institutional investors to own listed firms. And second, in 1982, following the debt crisis, the government restricted bank' holdings of company shares. The latter explains the small presence of banking ownership in Chile (3.2percent in average). Foreign investors directly own 17.4percent of shares (see Table 1) with foreign multinational firms also making use of pyramidal structures (i.e., Grupo Agbar and Grupo Telefónica, from Spain). Additionally, international banks indirectly held shareholding through pension funds and insurance business (i.e., Grupo Santander).

Ownership Structure in South Korea

Large business groups, often referred as *Chaebols*, characterize the ownership structure of corporations in Korea. *Chaebols* have significant economic influence in the Korean market. For example, in 2004, the *Chaebols* accounted for 14 percent of the total value added of the manufacturing sector and more than half of the total market value of all publicly listed firms (Almeida et al. 2007). *Chaebol* firms operate in many different sectors, maintain strong business and network ties with other affiliated firms, and are mostly family-controlled (Bae, Baek and Kang 2007). However, *Chaebol* firms are not allowed to hold the shares of commercial banks and, as a consequence, diversify into non-banking financial institutions in order to expand the capacity and flexibility of their internal capital markets (Kim 2010).

Chaebols are also characterized by pyramidal structures and cross-shareholding. Pyramids in Korean chaebols are not "complex" in the sense that the large majority of *chaebol* firms belong to pyramids with a total of two or three firms in the chain (Almeida, Park, Subrahmanyam, and Wolfenzon 2010). In addition, cross-shareholding enabled *chaebols* to develop a governance structure like the multidivisional organization, under which individual affiliates function as operating divisions that are controlled by group-level staff (Chang 2003). Cross-shareholding was significantly higher for *Chaebols* and increased even just after the Asian financial crisis in 1997. For instance, in 1998, the cross-ownership for listed firms that belonged to *Chaebols* averaged 27.7 percent, compared to 17.8 percent for non-*Chaebol* firms (Bae and Jeong 2007). However, state intervention and efforts at corporate restructuring caused *Chaebols* to gradually diminish cross-shareholding. From 1990 to 2009, except during the Korean financial crisis, internal ownership for the top 10 business groups is less than 50 percent (KFTC report 2009). Even though limited by law, the rate of cross-shareholding in Korea is above the average for the nine East Asian countries (Claessens et al. 2000). Also, as a result of pyramidal structures and cross-shareholdings, *Chaebols'* shareholders have high control rights compared to cash flow rights, becoming an incentive for tunnelling and propping up (Bae and Jeong 2007, Bae, Cheon, and Kang 2008; Almeida et al. 2010).

In 1997, during the Asian financial crisis, domestic and foreign economic institutions reached a consensus that the high leverage, over-diversification, excess of capacity and the resulting weak competitiveness of Korean firms together with the poor corporate governance of the *Chaebols* ownership structure were the main determinants of the Korean economic collapse. As a way to control the "Asian Contagion," the IMF stepped in and designed strict monetary and contractionary fiscal policy recommendations which included fiscal policy discipline, tax reform, trade liberalization, inward foreign direct investment liberalization, privatization of state enterprises, deregulation and legal security for property rights. Accepting much of this, Korea revised its financial regulation, the securities and exchange act and the commercial codes to facilitate market-based governance and encourage diversified investors to invest in Korean firms. As an illustration, before the financial crisis, foreign investors were not allowed to hold more than seven percent of shares in Korean domestic firms. These barriers of entry were lifted increasing foreign ownership in Korea from 13 percent of publicly listed firms in 1997 to 42 percent in 2006 in terms of market capitalism (Moon 2006).

As illustrated in Table 3, foreign shareholders exceeded more than 15 percent of the stock market capitalization in 2003 and above 20 percent in the following three years. More than 40 percent of these foreign investment came from two Anglo-Saxon countries, the U.S. and the U.K., and two thirds of investors were institutional investors as of the end of 2003 (Korea Stock Exchange, 2004b). Foreign investors are more likely to hold the share of conglomerates or members of *Chaebol* than middle sized firms. Interestingly, during the 1997 Korean financial crisis, firms with larger equity ownership by foreign investors experienced a smaller drop in their share value. Firms with higher disclosure quality and those with access to alternative sources of external financing also suffered less from the exogenous shock. In contrast, *Chaebol* with concentrated ownership by owner-managers and those with concentrated ownership by affiliated firms experienced a larger drop in equity value (Baek, Kang and Park 2004). Table 3 also reports the decrease in the governmental shareholding after the Asia financial crisis, which is an evidence of the privatization and divestitures of state-owned firms in Korea. Furthermore, and in line with previous research (Almeida et al. 2010), we report that individual investors, which include family-owned firms, hold more than 35 percent of market shares.

Insert Table 3 about here

After the financial crisis, the Chaebols also had to undertake several structural reforms to improve financial transparency and strengthen their corporate governance structure (Bae et al. 2008). The Korean financial supervisory agency was concerned about the high level of ownership concentration of publicly listed firms and engaged in closer supervision on the amount of individual shareholdings. As a consequence, the securities and exchange act defines: “largest shareholder” as a person or institution, domestic or foreign, who holds the largest number of outstanding shares (i.e., voting right shares) including common stocks or depositary receipts; “significant shareholder” as a shareholder who owns more than 1/100 of total shares issued by a firm; and, “minority shareholders” as stockholders who own stocks or certificates that represent less than 1/100 of the total amount of outstanding stocks. Thus, largest, significant and minority shareholders are the categorization from which we can estimate the degree of ownership concentration in Korean firms[6]

In this regard, Table 4 shows the ownership concentration of the largest, significant, and minority shareholders of the Korean Composite Stock Price Index (i.e., KOSPI) firms. It

[6] Other includes shareholders who have special relationship with a largest shareholder, including family or employment relation. The Korean tax regulation, Article 20, Enforcement decree of basic act for national taxes, defines the scope of relatives and special related person.

represents 80 percent of listed firms for the period from 2004 to 2008[7]. Minority investors also have a large percentage of the total shares, which is almost the same as largest investors do. However, this does not necessarily mean that minority shareholders are well-protected by the Korean financial regulation.

In *Chaebols*, lower levels of family and affiliate ownership does not imply that there is less monitoring, since affiliates function like business divisions in diversified corporations controlled by the Chaebols' chairmen (Chang and Choi, 1988). Any observed relationship between concentrated ownership and performance may be attributable to "tunnelling," which Bertrand, Mehta, and Mullainathan (2002) defined as transferring resources from firms in which a controlling family has few cash flow rights to ones in which it has substantial cash flow rights. Chaebol families and affiliates may decrease their shares in those affiliates that provide or receive such debt guarantees in order to reduce their own downside risk (Chang 2003).

Insert Table 4 about here

Chaebol controlling families have substantial incentives to maximize firm performance over time and to pass control of the firm to their descendants rather than consume the wealth during their lifetime (Anderson, Mansi, and Reeb, 2003). In fact, these families are strongly identified with their business groups. These patterns have enabled family ownership and control to contribute to the rapid growth and long-term success of the *Chaebol*. Joh (2003) finds that, between 1993 and 1997, a firm's profitability increases when the controlling family's ownership is high, controlling for firm, industry, and macro-economic effects. However, during the 1997 Korean financial crisis, family-controlled *Chaebol* firms with concentrated ownership experienced a large depreciation in their market value. Firms in

[7] The number of listed companies in KOSPI is the following: 683 in 2004, 702 in 2005, 731 in 2006, 746 in 2007, 765 in 2008

which the controlling shareholders' voting rights exceeded cash flow rights and those who borrowed more from the main banks also had lower returns (Baek et al. 2004).

Our sample reports that, from 2000 to 2008, family ownership among publicly listed firms gradually decreased from 7.5 percent to 3 or 4 percent, which implies that the traditional family owned structure has weakened given the Korean government effort to dilute corporate ownership, especially the shareholdings of major shareholders, including the largest and significant shareholders[8]. However, this does not entail the collapse of the controlling power of families, particularly in business groups, as that would require not only that family control decreases but also that cross-shareholdings and pyramidal structures no longer exist. In fact, in 2009 the KFTC reports that internal ownership, which represents the sum of family direct shareholding and cross-shareholdings, of the top 10 business groups is still more than 50 percent. Despite criticism for their lack of transparency and patriarchal management, *Chaebols* are continuing to engage in the generation-to-generation transfer of ownership, with one-third of the top 50 family-owned businesses already having concluded the succession process.

In sum, although family owners have contributed to the rapid growth in the Korean economy, questions about their corporate governance efficacy and their overall influence in South Korean society have long cast a shadow over their success. Family owners are expected to transform their corporate governance structures to demonstrate that they have turned a corner in terms of transparency, accountability and integrity.

Ownership structure in Central and Eastern Europe

Since the collapse of the Communist system two decades ago throughout Central and Eastern Europe (hereafter, CEE), the region has undergone a remarkable economic and political transformation. Unlike Latin American countries, which undertook economic and

[8] We measure the family shareholding (defined as the shareholding by the largest shareholder -individuals and their family members) as the sum of the direct equity ownership, not including the indirect shareholdings. We also sum up the outstanding stock shareholding.

political transitions at roughly the same time, the East European transition involved fundamental transformations of property regimes. And while the East Asia democratization started only after they established links to the globalized economy, Easter European political transformations occurred simultaneously with economy liberalization, privatization, and globalization process (Bandelj 2008).

At varied speeds and in different ways, Czech Republic, Hungary, and Poland transformed their former planned economies into market economies, implementing various political, economical and institutional changes that characterized social change in Central and Eastern Europe after 1989. Influenced by integration with European Union and pressured by international financial institutions, the privatization and internationalization of CEE firms contributed to more efficient economies and introduced new corporate ownership structures. We discuss each of the three countries in the following sections.

Czech Republic

After the "velvet revolution" in 1989, the Czech Republic was the third CEE country to start a privatization program in the context of a transformation from a centrally planned economy to a market economy. There are three singular characteristics of the Czech approach (De la Dehesa 1991). First, the government used generous incentives to attract foreign investors into joint ventures. Second, a Restitution Law allowed the previous owners of state assets nationalized after 1948 to regain control. The restitution applied mainly to small and medium-sized service firms and to real estate (Havrda 2003). And third, the Czech Republic had the most state-ownership than any other CEE country due to the fact that the workers' councils had been dissolved in 1990 and the enterprises involved were re-nationalized.

The privatization process was divided into three schemes: the natural restitution, small-scale program and large-scale privatization. The first two schemes were carried out in the early stage of privatization process. Thus, small firms, stores, and real state were returned to the original owners or their descendants based on the cutoff date set to the year 1948 (Havrda 2003). Also, small and medium-sized firms were privatized through auctions, sale in tender offers, or direct sales. By this scheme, foreigners could bid only if the first auctions failed to reach the minimum price, set at 50 percent of book value (De la Dehesa 1991; Ježek 1994). The third scheme, defined by the "Transformation Law", included the larger firms. The companies prepared privatization projects and presented them to the Ministry of Privatization; then potential owners competed and the Parliament made the final allocation decision. Light industries were privatized first, followed by heavy industry, including utilities and 'strategic' industries.

In these projects, the voucher privatization method was the main mechanism in redistributing companies' shares. Yet, only part of the firms' equity were available for auction using the vouchers, in many cases 40 percent and, exceptionally, up to 80 percent. For the remaining shares, a small percentage was distributed to employees, another amount was put available to foreign buyers, and finally, the states maintained ownership of the residual shares for future transactions (De la Dehesa, 1991).

The voucher mechanism resulted in the creation of the Investment Privatization Funds (IPFs), mostly indirectly operated by banks, which control connected corporations (Khanna and Yafeh 2007). There were about 400 IPFs, which obtained over 70 percent of all available vouchers and the seven largest funds obtained 46 percent of all vouchers in the market (Havrda 2003). However, since the Czech government did not want the IPFs to be active monitors and influence the management of firms, it set strong legal limitations on the IPFs actions. For example, an investment fund could not invest more than 10 percent of its assets in the same company or could not own more than 20 percent of the share of one company (Havrda 2003). As a result, in 1996, some IPFs began to transform themselves into holding companies to avoid such regulation and supervision, and consequently it led to ownership concentration, as existing regulation did not apply to the holding companies.

Due to the unintended consequences of the privatization process, ownership concentration reached high levels again by 2001. Klapper, Laeven and Love (2006) describe the ownership behavior of CEE firms in 2001 and report that in the Czech Republic 69 percent of shares were concentrated in the largest shareholder and 89 percent in the five largest shareholders. Also as a result of the privatization program, which focused on the participation of foreign investors as a way to develop an emerging capital market, and also due to foreign direct investments from other European countries, the foreign ownership in Czech publicly listed firms has a high presence as shown in Table 5. Almost half of the firms had a foreign investor in 2001and, when present; they held, in average, 38 percent of firms (Klapper et al. 2006)

Our 2004-2008 data shows another important trend. The Czech Republic has the highest remaining government ownership, while Hungary and Poland have very few state-owned firms among their publicly listed firms (see Table 5). Kočenda and Hanousek (2009) analyse the determinants of state ownership over privatized firms in the Czech Republic during the post-privatization decade (1995–2005) and argue that there are three main institutions through which the state still keep the control of larger firms. The first institution, and the fundamental one, is the National Property Fund (NPF) that was set up to control the remaining shares after the privatization scheme was finalized. Also, Municipalities received various ownership stakes as free property transfers and became stakeholders in a diverse number of firms, mainly in utilities and transportation sectors. Finally, other state agencies were created to hold shareholdings in 'strategic' sectors to protect government interests. Kočenda and Hanousek (2009) suggest that the state remained as a major owner of privatized firms during the period between 1996 and 2005.

Insert Tables 5-7 about here

The data for the XXIst century is consistent with prior findings regarding high ownership concentration. In Table 6, on average, the largest shareholder of Czech Republic hold 56.7 percent and the three largest shareholders together hold more than 80 percent, between 2004 and 2008. In 2004, Czech Republic joined the European Union and an immediate consequence of their membership was that foreign direct investment increased sharply, as investors positioned themselves to take advantage of the cheaper labour and the bigger and more stable internal market offered by the progressive unification of Europe. In fact, our data capture this trend and show that the foreign direct ownership remarkably increased since 2004, from 32.5 to 58.6 percent. Our data consider the 2004-2008 period (see Table 7) and confirm that the Czech Republic has the highest remaining government ownership, which is consistent with the late stage of privatization process when compared to other CEE countries.

Hungary

Hungary was the first country in the CEE region to launch the privatization process. Perhaps, because unlike other CEE countries, in Hungary, the party-state did not collapse. Rather, its termination was negotiated. In three months of intensive negotiations, representatives of both ruling and major opposition parties reached an agreement about the new rules of the political game, leaving aside the economic front. In spite of the economic policy “vacuum,” the Hungarian economy was not “out of control,” and two pieces of legislation formed the first mechanism of privatization, so-called “spontaneous privatization” (Stark 1990). The first was the 1984 Law on Enterprise Councils, which transferred the ownership functions from ministries to enterprise directors. And the second piece, enacted in

January of 1989, the Law on Business Associations, contained a clause allowing state-owned firms to found shareholding corporations and limited liability firms. These two laws together enabled company managers to sell either assets or entire companies and get, in return, high salaries, guaranteed jobs and excellent retirement terms (Stark 1990; De la Dehesa 1991).

A State Property Agency was established in 1990 with the responsibility to organize and supervise the privatization process. It is worth noting that to carry out its mandate and to mitigate the consequences of "spontaneous privatization," the agency embarked on several privatization initiatives. First, the pre-privatization program aimed at a rapid transfer of small and family-scale businesses into private hands through a simplified procedure. Second, the investor-initiated privatization was open to domestic and foreign parties alike. Third, the active privatization was a set of initiatives to solicit privatization of specifically designated state firms, typically the largest Hungarian firms. And finally, self-privatization was a mechanism where state-owned firms below a certain scale threshold but often still reasonably sizable could select private consulting firms to assist them in the privatization process (O'Toole 1994; Stark and Bruszt 1998; Bandelj 2008).

Although the Law of Business Associations did not explicitly endorse concentrated ownership, establishing a minimum price of a share at one million forints was accessible to institutional or corporate shareholders rather than to private individuals (Stark 1990). Indeed, previous research reports a highly concentrated ownership structure for Hungarian firms (see Table 5). Additionally, foreign investors were in the scene early in the transition as the privatization methods comprised insider's buy-outs and direct sales to strategic investors, included foreign investors. Iwasaki (2005) suggests that few and strong owners were preferred to achieve a fast and effective privatization instead if widely dispersed owners. Our data for the early XXIst century (2004-2008) confirms the continuation of this early concentration trends, as in average, the largest and three largest shareholders held 48.7 and 68 percent of shares, respectively (see Table 6).

Among CEE countries, we can see that foreign ownership is most prominent in Hungary (see Table 6). This is because Hungary opened their economy to foreign direct investment earlier than other transition countries, and the Hungarian government and international pressures such as joining the EU put a considerable effort to attract foreign investors (Iwasaki 2005; Filatotchev, Isachenkova and Mickiewicz 2007). Even sectors such as banking which have been typically left in domestic hands, were transferred to foreign hands - e.g., 60 percent of the capital in the banking sector was foreign by the end of 1997 (Iwasaki 2005).

Poland

In 1989, Solidarity trade union established a new government in Poland and was a trigger to the political, economic and institutional change. One of the first economic polices was to privatized state-owned firms. As in other countries, Polish firms were not all privatized at the same time. This was due to political constraints (Roland, 2000) and practical reasons, such as the sheer logistic difficulty of privatizing an entire economy in one go (De Fraja and Roberts 2009).

The Polish Government set up a three-stage privatization process where about 600 large and medium-sized firms were privatized. The first stage is the defined by the commercialization of a state-owned firm, which can take one of three techniques, initial public offering, direct sales to investors and a combination of bought. The second stage is the establishment of 20 National Investment Funds (i.e., NIF) in the form of joint-stock companies. These funds were delegated to special consortia, which comprised of commercial and investment banks, and consulting firms operated by Polish and Western partners which compete one another according to the best offer to the Government. The third, and final, stage comprised of the distribution of certificates to polish citizens who became indirect shareholders of the companies by receiving one share of each NIF.

In Poland, privatization played a significant role in improving firm incentive systems and restructuring corporations as it established corporate governance reforms to restructure firms. Grosfeld and Hashi (2007) argue that the Polish authorities centered on the proper development of the financial market and placed great emphasis on the creation of a well-established legal system and enforceable laws from the initial phase of transformation. However, the program was also concerned with the potential danger of private benefits of control and therefore enforced the limit of 33 percent on the lead fund's holdings in each firm.

As in Hungary, the Law on the Privatization of state-owned firms indirectly influenced the concentration of ownership on new publicly traded firms. In fact, Table 5 reports that the largest shareholder held, in average, 39 percent of shares while the five largest shareholders exceeded 64 percent, in 2001. In addition, in our population of 1,228 Polish firm-year observations from 2004 to 2008, we show that such patterns have not changed and the largest shareholder continues to hold 41 percent of shares while the three largest shareholders account for 59 percent.

However, Poland has relatively less concentrated ownership when compared to the Czech Republic and Hungary. Scholars suggest that ownership concentration is lower in Poland for the three reasons (Grosfeld and Hashi 2007): investor access to greater amount of firm information (financial reports and governance practices); the financial market developed effective mechanisms to monitor firms; and the Warsaw Stock Exchange limited the level of ownership concentration.

Conclusion

Our basic argument in this chapter is that emerging countries carried out very different institutional and economic reforms to transition to market economies, get involve in the international markets and improve their domestic capital markets with the goal to ultimately increase economic growth in an environment where there was high information asymmetry among owners (particularly majority and minority) and the legal protection of for minority shareholders was weak.

Moreover, if we were to draw on the globalization/convergence literature, which includes the neo-liberal perspectives pushed by international organizations such as the IMF, we would expect that market-oriented legal and economic reforms in country-level governance would foster investor protection and, consequently, reduce highly concentrated ownership among publicly listed firms. Our data analysis for publicly listed firms in emerging markets in the first decade of the XXIst century as well as previous research covering ownership trends since the initial transformations to opened market-economies, demonstrates that this was not the case.

Our unique dataset of 19,969 firm-year observations from 2004 to 2008 in six emerging markets displays that high levels of ownership concentration are still the common denominator in these countries, although the paths to this trend differ. In addition, in Latin America and South Korea, business groups represent the most important organizational form as the largest shareholder of publicly listed firms not only through direct shareholdings but also using pyramids and cross-shareholdings. In Central and Eastern European countries, joining the European Union triggered the impulse for transfer of ownership from state to private hands with the immediate consequence of large entry of foreign direct investments and its related foreign ownership of publicly traded firms. These patterns of corporate ownership illustrate that, although countries' corporate governance systems have been influenced by cross-border regulatory arrangements to facilitate and expand national capital markets, in emerging economies, the business groups (Latin America), the families (Korea) and the government (CEE) play an important role in defining the corporate governance agenda. As emerging countries are more important to inward investors from developed economies, these groups have a significant authority and may influence the behaviour of MNCs in emerging markets as argued by Whitley (forthcoming) in this volume.

Our findings show that together with ownership structure, legal systems and their related corporate law, the development and structure of capital, and the political and economic institutions define the myriad of varieties of capitalisms that, ultimately, characterize corporate governance systems in the emerging economies (Hall and Soskice 2001). And, more importantly, the similarities in ownership concentration level and legal systems only partially account for governance realities in these countries. This implies that to better understand and compare corporate governance practices at country level, we should take into account other determining factors such as economic history, formal and informal institutions, the political process, the social actors, and the firms themselves making choices.

This chapter yet opens new avenues of future research in emerging markets. One is the role of business groups in shaping the corporate governance agenda in these countries, in particular, in East Asia and Latin America. Its internal governance practices, the relationship of parent and subsidiary control, the relationship between family members and other type of shareholders are still understudied. Our research has shown that ownership concentration continues to be a pattern in emerging markets yet it is interesting to observe that there are shifts on who the owners are and that Anglo-American investors are typically sceptical to invest in majority owned firms. Future research should also examine how different owners interact with each other in these path- dependent ownership concentration model as well as what the role is of new types of owners such as different institutional investors, re-invented family owners a lot more aware of the international pressures for transparency and accountability, as well as sovereign wealth funds, just to mention a few.

When it comes to empirical research, it is worth noting that there has been a scarcity of systematic comparative research particularly in emerging markets, usually due to the lack of reliable data. Therefore, there is an opportunity for those who can develop updated data sets to explore the characteristics of financial, ownership, governance and business practices in emerging countries and to study how structural firm characteristics interplay with broader industry and national institutional pressures.

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Table 1. Direct shareholdings concentration of Brazilian and Chilean firms, 2004-2008

Year	Brazil				Chile			
	Largest shareholder	Three largest shareholders	Foreign shareholders	Domestic Shareholders	Largest shareholder	Three largest shareholders	Foreign shareholders	Domestic shareholders
2004	50.3	66.1	18.0	82.0	51.1	69.5	18.7	81.3
2005	50.0	66.6	21.3	78.7	51.5	69.9	16.8	83.2
2006	49.3	67.0	25.8	74.2	50.9	69.4	16.7	83.3
2007	47.1	65.5	27.7	72.3	50.4	68.8	18.3	81.7
2008	49.2	66.9	28.2	71.8	49.1	68.1	16.5	83.5
Mean	49.1	66.4	25.0	75.0	50.6	69.2	17.4	82.6
SD	26.7	23.5	-	-	25.8	22.8	-	-
Min	4.5	5.7	-	-	0.4	0.7	-	-
Max	100.0	100.0	-	-	100.0	100.0	-	-
N	1,519	1,519	1,519	1,519	1,077	1,077	1,077	1,077

Source: Compiled by the authors. Mean value of ownership concentration by largest shareholder and three largest shareholders, between 2004 and 2008, of Brazilian companies listed on the São Paulo Stock Exchange and Chilean companies listed in the Santiago Stock Exchange.

Table 2. Direct shareholdings by type of shareholder of Brazilian and Chilean firms, 2004-2008

Country	Year	Type of shareholders					
		Individuals	Government	Bank	Institutional investors	Industrial firms	Others
Brazil	2004	12.6	5.3	25.1	10.2	45.9	0.9
	2005	12.8	6.2	27.1	7.7	46.0	0.4
	2006	12.4	4.7	29.3	13.4	38.6	1.7
	2007	13.1	4.0	31.6	12.9	37.6	0.7
	2008	12.3	5.0	32.3	15.4	34.0	0.9
	Mean	12.7	5.0	30.0	12.8	40.1	1.3
Chile	2004	3.3	1.6	2.8	20.1	71.4	0.9
	2005	3.0	1.6	3.2	17.9	73.5	0.9
	2006	3.0	1.5	3.8	18.7	72.2	0.9
	2007	2.9	1.5	3.4	20.9	70.4	0.9
	2008	3.0	1.0	2.7	21.8	70.6	1.0
	Mean	3.0	1.5	3.2	19.9	71.6	0.9

Source: Compiled by the authors. Mean value of ownership concentration by type of shareholders, between 2004 and 2008, of Brazilian companies listed on the São Paulo Stock Exchange and Chilean companies listed in the Santiago Stock Exchange.

Table 3. Direct shareholdings by type of shareholders of South Korean firms, 2000-2009

Year	Type of shareholders				
	Individuals	Government	Institutional investors	Industrial firms	Foreigners
2000	37.7	12.7	15.8	20.0	13.8
2001	38.5	7.3	19.2	20.3	14.7
2002	35.4	7.4	24.6	21.0	11.5
2003	37.1	6.7	16.5	21.7	18.0
2004	33.8	6.4	18.9	19.0	22.0
2005	34.2	5.0	18.6	19.3	23.0
2006	35.5	4.8	17.0	20.4	22.3
2007	36.5	4.4	15.5	24.7	18.9
2008	45.8	4.6	7.1	26.4	16.1
2009	49.9	1.5	15.6	16.7	16.3

Source: Compiled by the authors from Korean Exchange (KRX) Statistics database.

Table 4. Direct shareholdings concentration of South Korean firms, 2004-2008

Year	Largest shareholder	Significant shareholders	Minority shareholders	Others	Korea securities depository
2004	33.8	6.4	36.7	23.0	0.1
2005	34.3	5.4	36.7	23.7	0.1
2006	34.9	5.3	36.5	23.2	0.1
2007	38.4	4.6	35.8	21.1	0.1
2008	39.9	3.9	35.7	20.4	0.1

Source: Compiled by the authors from TS-2000, Korean Listed Companies Association database.

Table 5. Ownership structure of CEE firms, 2001

	Number of firms	% of firms with ownership by			Average % of firm shares held by			% of firms with largest shareholder owning over 50%
		Foreigners	Government	Bank	Foreigners	Largest shareholder	Five largest shareholder	
Czech Republic	74	47	27	11	38	69	89	70
Hungary	56	70	7	18	43	52	96	52
Poland	56	32	11	4	19	39	64	25
All Sample[a]	224	46	17	11	31	56	83	54

Source: Adapted from Klapper, Laeven, and Love (2006). [a]The original data includes Slovak Republic.

Table 6. Direct shareholdings concentration of Czech, Hungarian and Polish firms, 2004-2008

Years	Czech Republic				Hungary				Poland			
	Largest shareholder	Three largest shareholders	Foreign shareholders	Domestic shareholders	Largest shareholder	Three largest shareholders	Foreign shareholders	Domestic shareholders	Largest shareholder	Three largest shareholders	Foreign shareholders	Domestic shareholders
2003	53.9	84.9	29.4	70.6	42.6	64.1	52.5	47.5	39.7	53.6	26.5	73.5
2004	53.1	80.9	32.5	67.5	46.0	64.3	47.2	52.8	40.9	57.9	20.4	79.6
2005	52.4	80.4	31.5	68.5	43.8	64.6	53.4	46.6	41.0	57.6	22.3	77.7
2006	56.7	75.7	48.4	51.6	41.8	60.2	57.2	42.8	42.4	59.5	20.6	79.4
2007	63.4	82.6	57.7	42.4	49.6	65.4	62.2	37.8	40.4	59.3	19.7	80.3
2008	60.6	76.0	58.6	41.4	54.2	71.5	70.6	29.4	36.2	50.4	21.9	78.1
Mean	56.7	80.7	43.0	57.0	48.7	68.0	57.2	42.8	41.0	59.3	21.9	78.1
SD	20.4	20.0	-	-	25.1	27.6	-	-	24.0	28.4	-	-
Min	1.7	0.6	-	-	4.5	6.7	-	-	3.5	3.5	-	-
Max	100.0	100.0	-	-	100.0	100.0	-	-	100.0	100.0	-	-
N	71	71	71	71	96	96	96	96	1,228	1,228	1,228	1,228

Source: Compiled by the authors from Amadeus database.

Table 7. Average direct shareholdings of CEE firms by type of shareholder, %, 2004-2008

Country	Type of shareholders					
	Individuals	Governments	Banks	Institutional investors	Industrial firms	Others
Czech Republic	1.0	12.7	2.8	32.2	44.0	7.4
Hungary	4.3	2.4	2.7	12.2	62.8	15.6
Poland	37.6	4.8	2.9	14.1	40.1	0.4

Sources: Compiled by the authors from Amadeus database.