CORPORATE GOVERNANCE IN ARGENTINA

New Developments through 1991-2000

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Abstract

This paper develops and provide evidence for three statements: a) In Argentina, there has been a marked shift in corporate governance structure from big family-owned domestic companies towards foreign groups and investment funds ownership. b)While coping with governance issues, Argentina has been performing as if it were following the common law countries tradition. c) The capital markets development has been nurturing contradictory forces which could bring about alternative governance structures in the foreseeable future. To ground these statements on facts, we previously survey corporate governance issues in Argentina before 1991, the underlying legal framework, the new rules of the game in capital structure and ownership as from 1991, largely due to a wave of privatizations, restructuring, mergers and acquisitions that has taken place through the last decade.

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1.- INTRODUCTION

“Corporate Governance” seems to be a growing concern among academics, practitioners, law-makers, and company’s stakeholders. This is not to be surprised because corporate governance, as the time being, has to do with ownership and control, incentives and accountability, direction and performance design, incomplete contracts and agency problems. Since the Berle and Means (1932) well known book, the concept went a long step further from the study of the separation of ownership and control which led to the first widely accepted meaning of corporate governance. It was after encompassing research by Jensen, Fama, Williamson and Hart, among others, that the subject established itself as complex field which should give due regard, in the first place, to contractual and agency problems arising from bounded rationality and opportunistic behavior and, in the second place, to accountability, performance and power design. A comprehensive survey on these efforts can be found in Shleifer and Vishny (1986). A truly encompassing work in comparative analysis of governance structures from advanced economies can be found in Demirag (1998).

At present, there is a widespread consensus about the need to frame corporate governance issues into the context of corporate law, as it was done in Easterbrook and Fischel (1991) or in La Porta, de Silanes, et al (1998, 1999). As long as globalization unfolds to a clear-cut shape, big changes have been cropping up in most countries around the world. The main outcome of this evolving process was a distinctive interest in addressing corporate governance problems in emergent economies, from either Latin America and Asian countries, or in the transitional economies spread over eastern Europe. It is worthy of praise, hence, that the first seminar on corporate governance in Latin American Countries took place in Santiago, Chile, in September 1999, with papers by Shleifer, Colin Mayer, Lefort and Walker, Apreda, among others (see References).

It is from this viewpoint that Argentina seems a worthy case-study (Apreda, 1999a). From being a rather closed economy, with an impressive roster of state-owned companies, distressing regulatory surroundings and inefficient industries, Argentina became an open and almost liberal economy, it curbed inflation and dismantled most of the state ownership of industries and services, fostered the capital markets and privatized pension funds.

What we want to do in this paper can be broken down into the following stages:

~ Firstly, we will review corporate governance in Argentina before 1991, because that year meant the starting point of an impressive turnout in the economy as a whole.

~ Next and from 1991, we wish to put the new developments into some kind of perspective from which we may eventually draw conclusions about corporate governance after the privatizations, deregulation and restructurings that took place through the last decade.

~ After that, we intend to deal with the main statements this paper sets forth, providing factual evidence to them, each at a time.

2.- CORPORATE GOVERNANCE IN ARGENTINA, BEFORE 1991

Seven features may provide for gradual understanding about how corporate governance unfolded in Argentina before 1991.

Ownership Structure

All throughout this century the biggest domestic groups were personal or family-owned, with a strong majority held in the founders' portfolios. Most of the stock was kept closed and shares placements stayed private. This sort of ownership structure gave those groups greater flexibility in decision-making through unstable contexts, easier mechanisms for settling inheritance disputes, and financing resources from their own banks (or from the state-owned ones by taking advantage of political networks). On this account, a Cepal Report on Argentina and other four latin-american countries is useful (Garrido and Peres, 1998)

Only insider directors were appointed to boards

Boards of Directors were nominated to act as deputies of the founding owners and, in many cases, owners themselves were seated at them. Managers were appointed on grounds of loyalty and fiduciary claims, to be closely monitored by the Board. It was frequent procedure to appoint as CEO just a member from the founding families.

Minority rights

It is widely acknowledged that law can help to manage agency problems, by giving protection to minority stockholders and outside investors, against wealth expropriation by insiders. Empirical research led by La Porta, de Silanes, et al (1998 and 1999) showed that Argentina, although belonging to countries whose law-systems have come from continental european Civil Law tradition, it performs on antidirectors rights as if it were one of those countries from Common Law tradition, where investor's protection is much bettter established. In fact, in many other things Argentina also departs from the Civil Law tradition countries, shaping a corporate governance system in the Common Law tradition, as we shall see further into more detail.

Anti-director rights mean minority rights as the ease of voting for directors, the possibility of electing directors through a cumulative voting mechanism, the existence of a grievance mechanism for oppressed minority shareholders, a clear statement about the percentage of votes neeeded to call an extraordinary shareholder meeting, and the existence of pre-emptive rights. A close watch on Companies Law (Law N° 19550) in Argentina, "Section V on Corporations", proves that anti-director rights are thouroughly granted by law.

Last of all, hostile takeovers were ruled out, either because of companies' charters or shareholders agreements. In any case, takeovers were friendly most of the time.

Dividends distribution

On the other hand, minority rights and outside stockholders were not really a distinctive problem during this long span of time. In fact, cash dividends were neither frequently distributed nor even provided a good hedge against inflation for many years, although there were certainly trade-offs to owners through fringe benefits, boards and managemente appointments, and dividends distribution in the guise of high salaries.

That is to say, companies didn´t consider relevant dividends distributions to build up their reputation in Argentina. In a way, they were kept isolated from the market for corporate control. This environment is consistent with research findings (La Porta, de Silanes, et al (1998,1999), because reputation is frequently sought by countries as a substitute to weak legal protection of minority shareholders, as it happens with Civil Law countries. Argentina seems to be, again, an exception.

For almost 80 years, no company issued any bond in the Capital Markets.

Is is an striking feature that no company in Argentina had ever issued bonds to finance themselves in the capital market since 1913 till 1991, when a public offer took place for the first time (Plus Petrol pc., Simple Negotiable Bonds Public Offer, December 91).

This uncovers an interesting fact: financing decisions actually deserted the so called standard pecking order: ploughing back profits into the company, external debt (bank loans and bonds) and last of all shares, in that sequence. On the contrary, financing decisions were carried out by means of internal financing and bank loans firstly and, lastly, issues of stock. Evidence can be drawn from companies listed in the Buenos Aires Stock Exchange: there were 278 of them in 1980, they dropped to 170 in 1991, plunging to 157 in 1994, to reach a rock bottom of only 130 listed companies in 1998.

Complementary explanations for this anomaly stem not only from taxation hindrances, but also from noncommittal attitudes of managers and Boards of Directors so as to avoid what they could have felt as unpleasant capital market exposure and monitoring. Besides, it was not so uncommon for family owned groups to have a bank in their own holdings, which was an easy lender for the companies involved. Furthermore, state national and regional banks were willing to grant soft loans on political grounds. And sometimes, those banks behaved so leniently as to forfeit their expected monitoring duties.

On the other hand, before 1991 and back to all this century, some foreign companies with big stakes in the country were always able to get cheaper funding from their headquarters and their own capital markets, overtaking their argentine counterparts.

Government was used to crowd out private borrowers from the Capital Market

Almost since 1950, current governments have been used to spend far above and beyond the collected revenues. Hence, governments eventually funded themselves in the capital market, a place where no private bonds were available.

It is no surprising that governments crowded out private borrowers by offering the best returns to investors, mainly commercial banks and some corporations. Besides, no institutional investors played any relevant role, but for some banks and insurance companies. The whole process, from an economic and financial viewpoint, can be followed in Apreda (1984).

Short-termism, innovation and performance

There is short-termism in a firm “when investment decisions made in that firm incorporate an excessive discount rate and/or a foreshortened time horizon” (Demirag, 1998). In this context, discount rate means cost of capital rate.

In Argentina before 1991, short-termism came out from long-lasting inflationary environment, an endless failure to honour contracts and a pervading exchange rate volatility. In this sense, either short-term projects rather than long-term ones were favoured, or the banks foreshortened their loans terms outright so as to hedge themselves. Both developments impaired innovations and sound strategies. This kind of short-termism greatly departs from the customary one in advanced economies, which is brought about by pressures from institutional investors, banks and market analysts. In the argentine background, there was a bank-based financial system, with a further qualification over the established meaning: there were not long-term but short-term banking finance, and also a widespread soft budget constraint culture, fostered by state-owned banks that were always ready to bail-out companies on political grounds. Analysis and evidence can be found in Apreda (1984).

Therefore, innovations were truly hampered by this context. There should be borne in mind that from 1930 till 1960 Argentina was a closed economy, with a huge number of state-owned companies, which made no investment whatsoever in research and development. Furthermore, those groups which main job was linked to commodities behaved as innovation-followers, and those groups which needed innovation on competitive grounds, built up strategic alliances as from the sixties with foreign companies (Garrido and Peres, 1998).

3.- THE LAST TEN YEARS INTO PERSPECTIVE

Along the period 1989-1991, the government had to cope with the hugest social and economic crisis in many years, taking up bold and innovative measures. On top of these, a program of ownership reform was set out in Argentina which paved the way for a new economic order.

In order to understand why those measures were so successful, we are going to follow two directions of analysis:

~ Firstly, we underline how political decisions were backed by a complex of laws which nurtured and balanced the whole development. As we keep on that path, we attach comments whenever we believe that to be useful.

~ Secondly, we have to briefly survey the new rules of the game introduced by the government, mainly through privatizations and financial restructuring.

3.1.- THE LEGAL FRAMEWORK

Broadly speaking, the current decade has shown an impressive number of laws being passed, which triggered off many innovative corporate and commercial developments.

Foreign Investment Law (Law N° 21382)

There are no requirements for the entry or repatriation of foreign investments, whether total or partial. Not even reserve ratios or limits on the remittance of profits obtained locally. Multinationals corporations receive the same treatment as local companies on taxation, labor regulations, access to raw materials and services. Foreign investors are entitled to use any of the corporate structures recognized by national laws.

National Securities Commission (Law N° 22169)

The NSC underwent many changes since 1990 and took daring steps to improve financial markets, instruments and dealers' performance.

Corporate Bonds Law (Law N° 23576)

This was the law that launched an extremely successful private bonds market in Argentina. Flexibly drafted, it allows simple and convertible bonds. The first issue, in the oil sector, dates from December 1991. So far, more than 25 billion dollars have been issued.

Mutual Funds Law (Law N° 24083)

An amendment to the former law introduced multi-purpose mutual funds, paving the way for diversified portfolios built up from government and private securities, time-deposits, metals or money markets portfolios.

Private Pension Funds Law (Law N° 24241)

Certainly, this Law meant an impressive achievement which enabled the government to curtail the disreputable state pension system, which was almost on the brink of collapse. Besides, it led the way to strengthen domestic saving, companies financing and a growing attendance of institutional investors in the capital markets. A thourough analysis of the pension funds system in Argentina can be found in Apreda (1995).

New Central Bank Chart (Law N° 24144)

Several major changes were introduced in the Central Bank Chart, so as to frame convertibility, the Currency Board, strong support to Capital Markets, and exacting measures to control financial institutions. From a political point of view, the Chart established that Directors must be appointed for six years, pending Senate agreement, keeping them independent from the government currently in office.

Trust Funds Law (Law N° 24441)

This law set grounds to financial fiduciary engagements and securitizations procedures. It has specific regulations on financial trusts and leasing contracts. By the time being, there is a forthcoming separate Bill on Leasing, which is overly awaited by banks, companies and investors.

New Penal Law on Taxes (Law N° 24769)

Tax and social security evasion were made criminal offences, with imprisonment terms from two to nine years. In case the evader were a government official, terms would be increased in a third plus lifelong debarring from taking any government job.

Tight Budget Constraint Law

This noteworthy bill has been passed on August 25, this year. It will provide a signpost to be used in decision making by financial markets, corporations, and foreign investors as well. For the first time, matching income with expenses, and keeping expenses gauged with the income level wil be compulsory. A zero-deficit level target for 2003 has been included.

Investors Protection Bill

It is currently being discussed in Represantives Chamber committees and would be sent as a Bill to both chambers eventually. So far, the National Security Commission has been using Rule 290, book 8, on transparency, to deal with these issues. However, an enforceable law would be much more desirable for the capital market.

3.2.- THE NEW RULES OF THE GAME IN CAPITAL STRUCTURE AND OWNERSHIP

The last decade in Argentina can be traced from many sides, but the relevant one to this paper seems to be the amazing shakeout in capital strucuture and ownership that took place, firstly in the Public Sector through privatizations, then in the private sector through corporate structural changes not only in ownership but in control as well. The main outcomes that this process brought about were:

~ Ownership concentration into large shareholders.

~ Founding families withdrawal from companies stocks, Boards of Directors and actual management.

To get an operational understanding of the process, we are going to deal, firstly, with privatizations. After that, with mergers, acquisitions and restructuring, providing evidence through an example drawn from the banking industry.

❑ PRIVATIZATIONS

Many emergent countries have learned it the hard way that simply transferring the ownership of state controlled companies to private hands, and breaking up state monopolies, did not directly lead to higher efficiency. As Tornell (1999) pointed out: " it is also necessary to privatize the privatized". What does this mean? Basically, it entails the fulfillment of three conditions:

(a) Restablishing property rights within each firm, so that new owners enjoy full residual rights of control.
(b) Restablishing property rights outside the firm, facing new owners with hard budget constraints, so that they couldn't get fiscal transfers or bail-outs.
(c) Setting up a non-corruptible judicial system, and transparent bankruptcy procedures that are free from political pressure.

<u>Evidence:</u>

- The privatization process dealt fairly well with (a) and (b), by means of an impressive body of laws that we have surveyed in the preceding section, and active commitment from investment banks and international consulting companies. Furthermore, the Central Bank increased its auditing over the banking system, improving the old fashioned bankruptcy and controlling methodology.

- However, there is a growing concern not only in the public's eye but in the current political debate as well, about the third issue. Nowadays, this seems the weakest point for the country to exhibit. A broad judicial system reform is still a pending problem to cope with.

- All in all, Argentina didn't face the frequent problems other privatizing countries met at fighting unions activism, regional vested interests, political opposition and patronage, and pressures from the network of suppliers. That is to say, it was easier to handle those stakeholders groups whose payoffs depend largely on the activities undertaken by the firms. On these strong tenets, in fact, it was that Argentina enjoyed such an impressive flow of foreign investment.

- From 1990 till 1994, multinationals' investment in privatizations amounted to between 57.7 and 66.3 % of the share capital of privatized companies. Almost 93 % of gross foreign investment came from USA, Spain, Chile, France, Great Britain, Italy, Canada. In particular:

~ USA, with 48 % of the total, mainly in oil, gas, electricity, distribution of gas.
~ Spain, with 11 %, in transport, electricity, communications, oil, gas transport and distribution, water, sanitation.
~ Chile, with 11 %, mainly in electricity.
~ Italy, with 8 %, in transport and distribution sector, highways concessions, communications and electricity.
~ Great Britain, with 8 %, in oil companies, water and sanitation, electricity and gas distribution.
~ France, with 7 %, mainly in water, sanitation, electricity, communications, oil and gas, and steel.

Foreign investment commitment in privatizations, for the 1990-1998, period, is displayed in table 1.

- One of the latest empirical works on this field, underwent by D'Souza and Megginson (1999) sticks up for the following statements:
    1. Transferring a stated-owned enterprise to private ownership significantly improves its performance.
    2. As D'Souza and Megginson state "the new-formed orthodoxy of privatizations means that it has been embraced as an instrument of political economy by governments of all political stripes".
    3. Output, operating efficiency, and dividends payments increase significantly.

By looking at financial statements of privatized companies, we can assess that the argentine experience meet any one of these statements. Furthermore, empirical work performed by Ramamurti (1997) on the privatized railways showed that there was a 370 % improvement in labor productivity, and 78,7 % decline in employement (from 92.000 to 18.682 workers) after privatization took place.

Table 1
Privatizations in Argentina: Foreign Investment
(in billions of dollars)

Year	***Investment***	***Year***	***Investment***	***Year***	***Investment***
1990	2,481	**1993**	4,451	**1996**	0,374
1991	2,330	**1994**	0,615	**1997**	1,360
1992	4,832	**1995**	1,395	**1998**	0,400

Source: Ministry of Economy, 1999

MERGERS, ACQUISITIONS AND RESTRUCTURING

Since 1994 up to present, as the privatization process weakened, a thriving activity in mergers, acquisitions and restructuring took place among domestic and foreign companies in Argentina. The main features to highlight are acquisitions of local private companies, expansion of existing companies and entrance of new multinational, as shown in Table 2, for the 1990-1998 period.

Remark:

Forecasted figures for 1999, taking into account the first semester events, amount to 18 billion dollars, mainly owed to YPF's sale to Repsol (Spain) for 13.4 billion.

Evidence: Allocation of mergers and acquisitions by countries split into this way:

USA (49%), Spain (21,6%), Chile (6,7%), Great Britain (6%), France (3,7%), Mexico (2,5%), Netherlands (2,1%), Brazil, Canada, Germany, Switzerland and Belgium (around 1 % each of them).

Table 2
Mergers and Acquisitions in the Argentine Economy 1990 - 1998

Foreign companies absorbing domestic companies	19,760 billions
Domestic Companies absorbing foreign companies	01,480 billions
Between foreign companies	05,880 billions
Between domestic companies	02,850 billions

Source: Ministry of Economy, 1999

If we wanted a broader picture of capital formation by highlighting the country which made the investment, the following table should be of interest for the 1990-1998 period:

Table 3
Capital Formation through Foreign Investment in Argentina (1990-1998)
(in billion of dollars)

Country	Expansion	Greenfield	M&A	Privatization	Total
USA	13,865	4,477	12,292	35,457	66,091
Spain	4,548	0,496	4,986	1,112	11,142
Chile	1,270	3,143	1,553	1,150	7,116
France	3,595	1,247	1,379	0,724	6,945
Britain	1,556	0,822	1,681	0,800	4,859
Italy	3,076	0,800	0,121	0,824	4,821
Canada	0,564	1,289	0,267	0,349	2,469

Source: Ministry of Economy, 1999, Production Research Center

MERGERS, ACQUISITIONS AND RESTRUCTURING IN THE BANKING INDUSTRY

The banking industry provides an impressive example of mergers, acquisitions and restructuring that has been taking place in Argentina for the last ten years. Although some privatizations of regional state-owned banks were practiced, the two biggest banks in the financial sector, De la Nación Argentina and De la Provincia de Buenos Aires still remain as state-owned and there is a heated debate over the convenience of making them public companies, as a prior step for a likely privatization.

As Table 4 shows, among the twenty-one largest banks in Argentina, only two are family domestic owned, five state-owned, one belongs to the biggest real estate investment company (Irsa), and the rest are foreign investments. This carries on a clear implication: by and large, corporate governance has greatly improved in the banking industry, because capital structure became more concentrated and agency relationships with management turned up more exacting.

Table 4
1998 Top Banks in Argentina

Corporation	***Controlling Shareholders***
De la Nación Argentina	State Owned
De la Provincia Buenos Aires	State Owned (Buenos Aires province)
De Galicia	Canabal (6,1 %), Lagancue (5,9 %) Caldela (5,9 %) Stock Exchanges (43,9 %)
Banco Río	Santander Investment (41 %), Sudecia (11,71 %), Perez Companc (7,4 %)
Banco Francés	Banco Bilbao Vizcaya (25,62 5), Sud America Investments (23,74 %)
Citibank	Foreign Ownership (100 %)
Boston	Foreign Ownership (100 %)
Hipotecario	Irsa (domestic real estate investment company)
Bansud	Banco Nacional de Mexico (39,9 %), Corporación Sud Americana (9,68%)
Nazionale del Lavoro	BNL Investments (97,23 %, foreign ownership)
HSBC Banco Roberts	HSBC Roberts SA Investments (97,23 %, foreign ownership)
De la Ciudad de Buenos Aires	State Owned (Buenos Aires City)
De la Provincia de Córdoba	State Owned (Córdoba province)
Scotia Bank Quilmes	The Bank of Nova Scotia (25 %), Scotia International (15,55 %)
Lloyds	Foreign Ownership (100 %)
Tornquist	O'Higgins Central Hispanoamericano (100 %, foreign ownership)
Banco Caja	Caja de Ahorro y Seguro (Wertheim, domestic family)
De la Pampa	State Ownership (69 %)
Morgan Guaranty Trust	Foreign Ownership (100 %)
ABN Amor	Foreign Ownership (100 %)
Sudameris	Banque Sudameris (99,9 %, foreign ownership)

Source: Mercado Magazine, July 1999

4.- THREE STATEMENTS ABOUT CORPORATE GOVERNANCE IN ARGENTINA

We believe the following statements may help to understand current features in corporate governance in Argentina. Due analysis and evidence will be provided for each of them.

<u>Statement 1</u>: In Argentina, there has been a marked shift in corporate governance structure from big family-owned domestic companies towards foreign groups and investment funds ownership.

This fact conveys remarkable consequences. Big stockholders blocks allow for much more activism while making managers more responsive to their concerns. It is well known that mighty shareholders get cheaper and better monitoring (Shleifer and Vishny, 1986).

<u>Evidence</u>**:** Table 1 offers a close picture of foreign investment directed to privatization commitments. Tables 2, 3 and 4 show how far foreign investment has been decisive in expansion, mergers, acquisition and greenfield operations. At this point, however, a stronger piece of evidence comes up from Table 5 on which the following remarks seem useful.

1. In the 1993's ranking of the 500 big groups in Latin America, the magazine America Economía (Dow Jones) showed that, among the 33 biggest ones, 73 % were broadly diversified. But in the 1999's same report, only 44 % were broadly diversified. Furthermore, this is a general trend for Latin American countries.

2. Before 1991, argentine biggest companies were diversified, and it was not so uncommon for a domestic holding to include a bank, which gave those groups comparative advantages at borrowing. Besides, those companies nurtured strong links with Politics and good access to subsidized funding from national and regional state-owned banks. As from 1991, capital structure changes were so impressive that much old fashioned rent-seeking behavior was prevented outright. On this account, Table 5 only highlights the 40 biggest corporations in Argentina. Another reliable source, "1999 Mercado Report" surveys the 1,000 most important companies and upholds the former remarks still much further.

3. It's worth drawing a conclusion from this table and the "Mercado's Report": as long as big domestic companies become sparse in the top list, they turn out to be much more desirable as likely investments. Therefore, further mergers, acquisitions, and restructuring should not be ruled out in the near future.

<u>Statement 2</u>: While coping with governance issues, Argentina has been performing as if it were following the common law countries tradition.

In a truly encompassing paper, La Porta, Shleifer, et al (1999) gave attention to corporate ownership around the world, picking up Argentina in their sample. We wish to advance new evidence and to draw some functional conclusions so as to shed more light to our subject.

Table 5
1998 Top Corporations in Argentina

Corporation	*Sector*	*Controlling Shareholders*
YPF	Oil – Gas	Repsol (Spain)
Exxel Group	Holding	Investment Funds (Usa)
Telefónica	Communications	Telefonica (Spain) and CEI Citicorp Holding (51 %)
Telecom	Communications	Nortel Investment (60 %)
Nortel	Communications	Nortel Investment
Socma	Holding	Macri Group, domestic family
Shell	Oil – Gas	Foreign Ownership (100 %)
Carrefour	Supermarkets	Soca BU France
Ford	Automobile	Foreign Ownership (100 %)
Phillip Morris	Tobacco	Foreign Ownership (100 %)
Grupo Clarín	Media	Noble, Magnetto, Aranda domestic families
Disco	Supermarkets	Foreign Ownership (100 %)
Cargill	Agribusiness	Foreign Ownership (100 %)
Massalin	Tobacco	Foreign Ownership (100 %)
Renault	Automobile	Foreign Ownership (100 %)
Volkswagen	Automobile	Foreign Ownership (100 %)
Supermercados Norte	Supermarkets	Exxel Group
Perez Companc	Oil – Gas	Perez Companc, domestic family and foundation
Fiat	Automobile	Foreign Ownership (100 %)
Arcor	Food	Pagani, domestic family
Siderar	Steel	Techint, domestic group
Coto	Supermarkets	Coto, domestic family
Lotería Nacional	Lottery	State Ownership
Molinos	Agribusiness	Perez Companc Group, domestic
Siderca	Steel	Techint, domestic group
Aerolíneas Argentinas	Airline	Andes Holding (63 %), American Airlines
Unilever	Cleaning	Foreign Ownership (100 %)
Esso	Oil – Gas	Foreign Ownership (100 %)
Edenor	Electricity	Electricidad Argentina (51 %) and E.France
Nobleza Piccardo	Tobacco	Foreign Ownership (100 %)
Edesur	Electricity	Distrilect (51 %), foreign investment
Deheza	Agribusiness	Urquia, domestic family
Osde	Health Care	Civil association, domestic
Sancor	Food	Small producers cooperative, domestic
Droguería del Sur	Drugstores	Machiavello, domestic family
La Plata Cereal	Agribusiness	Andre, Switzerland (95 %)
La Serenísima	Food	Mastellone, domestic family
Mercedez Benz	Automobile	Foreign Ownership (100 %)
Movicom	Telecommunications	Bell South (63 %) (USA)
Astra	Oil – Gas	Repsol (Spain)

Source: América Economía (Dow Jones), June 1999

(a) ***Privatizations, mergers and acquisitions and the capital markets development contributed to streamline the governance system as in common law countries.***

Evidence: Firstly, we must take advantage of former analysis in section 2. Furthermore, this trend has become stronger and stronger since 1991.

1. From the privatization experience, we can point at the large engagement of american, british, canadian and australian companies that retains a 55 % of investment share along the 1991-1998 whole period. By and large, foreign investors have been requiring multiple covenants in their loans, representatives in the boards, accountability practices to be set up as in their headquartes, and enforceable ownership rights.

2. Early in the 1990's, a sample of well known companies started successfully ADR programs, and some of them directly made public offers in american and eurobond markets (the leader was YPF when issued its 1994-2004 Fixed Rate 8% Bond). Behind such an achievement we must look for their lawyers, accounting-firms and investment banks, which influenced them for the indentures to be made as similar as they are supposed to be in global capital markets, inclusive of judiciary arbitration procedures in foreign counterparts.

3. Before 1991, Argentina's governance problems, mainly in financial decisions, has been very similar to the ones faced by Italy. In fact, since the end of the Second World War, Italian firms encountered high difficulties at raising outside financing (Zingales, 1996). They has been used to getting bank loans, mainly through the state-owned banks or private funding through main stockholders. The Italian capital market has been, most of the time, thin and narrow, with only a handful of private placements stocks. Ownership structure can be explained by big blockholders mainly from founding families (Melis, 1998). Therefore, Argentina is contesting this italian model.

(b) The Pecking Order and the Governance Structure Issue

The standard pecking order states that companies get firstly funded with internal resources (mainly benefits not distributed as cash dividends), then bonds issuances or bank loans, and stocks only last. Xuan and Mac Minn (1996) found that emergent and transitional economies start their funding with internal resources, then bank loans, next stocks issuances and at last bonds. This is consistent with a lack of strong capital markets.

Evidence: Argentine corporations have reversed twice this latter pecking order style:

~ From 1913 to 1991, main funding sources were available through internal financing and bank loans; only in unusual times did they resort to stocks. For foreign branches of multinationals, internal capital markets and local branches of foreign banks loans solved their problems.

~ From 1991 till present, the pecking order has consisted of internal financing, then bonds and stocks. Bonds were favoured by local companies, and stocks mainly for most mergers and acquisitions in private offers. Instead, most of privatized companies have been funded with internal capital markets from headquartes, or foreign institutional investors.

(c) Fighting a governance disease: The Soft Budget Constraint

Problems arising in the transitional economies have fostered a worthy bulk of recent academic work higlighting the soft budget constraints issue, which refers to the following environment: an unprofitable company is bailed out by the government or the company's creditors. That is to say, instead of being held to a fixed budget, the budget constraints are softed by additional credit when the company or bank is on the verge of failure (Maskin, 1999 and Lin-Tan, 1999).

The soft budget constraint issue has been topical in Latin American countries as well. In Argentina, before 1991, it was customary to help state-owned companies and banks. Surprisingly, almost all governments followed the same behavior with private-owned companies on political grounds, adding to their substandard performance eventually.

Evidence:

1. Examples of soft budget restraint were recurrent in Argentina before 1991, sometimes with devastating consequences for the public deficit, and far reaching damage on governance structure either in state-owned or private companies. From hotels (Potrero de los Funes, in San Luis and the Provincial in Mar del Plata), to health organizations under labor unions management; from private sugar-refineries in the northern states, to wineries in Mendoza; from regional state-owned banks to family or cooperative banks; from fisheries and leather industries to foot-ball clubs. Among the main reasons for this to happen it is frequently remarked that the two major banks (De la Nación and De la Provincia de Buenos Aires), still the most powerful credit-cartel in the financial system, furnished the financing and refinancing of projects that should never have been funded because they sharply failed on credit risk qualifications.

2. A clear-cut consequence for companies governance follows: as soon as softer budget constraints were at the reach of their hand, management started to perform as the bureaucracy was used to. It is well known that public ownership entails a bureaucrat who maximizes an objective function that is a weighted average of social welfare, his personal agenda and his sponsors' political agendas as well (Vickers and Jarrow, 1991).

3. Other grounds for soft budget constraints, so harmful to corporate governance because of the huge agency costs it brings about, are to be found in political patronage, jobs creation, search of political support and regional economies development.

4. Nowadays, however, corporations in Argentina have begun to fight this governance disease pervading the private sector by approaching the common law countries way of dealing with accountability issues, hard budget constraints, the Capital Markets acting as an efficient monitor and the Board of Directors as an strategic taskmaster.

<u>Statement 3</u>: The capital markets development in Argentina has been nurturing conflicting forces which may shape alternative governance structures in the foreseeable future.

Global Economy also means global capital markets, which give signals either on companies' achievements or failures, and expose managerial teams' performance to stringent monitoring beyond domestic borders. As Prowse (1999) clearly stated, such a process takes for granted the fulfilment of three kinds of expectations:

~ Enhanced accountability from companies
~ Efficient choice of investment projects
~ High-grade human capital to deal with information

Furthermore, there seems to be a premium on a system of governance whenever it can meet those expectations.

We are going to state that the capital market development in Argentina has been nurturing conflicting forces which may shape alternative governance structures in the foreseeable future. Such driving forces stem from the following contexts:

⇒ Private offers and internal capital markets are pervading choices among the most important groups.
⇒ Institutional investors are not performing as if following common expectations or incentives.

PRIVATE OFFERS AND INTERNAL CAPITAL MARKETS

With the help of Table 6, we see that a distinctive number of top corporations don't finance themselves in the argentine capital market. It is worth analysing four distinctive features in this context.

i. Private placements have become a handy choice worldwide.
ii. There are comparative advantages in foreign capital and Eurobonds markets.
iii. In most corporations, internal capital markets tap into cheaper finance.
iv. Although the furtherance of this process should improve long-termism, it could also lessen accountability standards to both investors and the market for corporate control.

<u>Evidence</u>:

1. In 1998 only 130 companies were listed in the Buenos Aires Stock Exchange (against 278 in 1980). Besides, in volume of transactions only five companies amounted to 67 % of the total volume, whereas the twenty biggest listed companies added up to 93,70 of such volume, as shown by the 1998 Buenos Aires Stock Exchange Annual Report.

Table 6 *1998 Top Corporations in Argentina*					
Corporation	***Main Sector***	***Sales Millions***	***Public Offer***	***Ownership***	***Exporting***
YPF	Oil – Gas	5.496	Yes	Foreign	Yes
Exxel Group	Holding	4.700	No	Local	Yes
Telefónica	Communications	3.435	Yes	Foreign	No
Telecom	Communications	3.173	Yes	Foreign	No
Nortel	Communications	3.173	No	Foreign	No
Socma	Holding	2.360	No	Local	Yes
Shell	Oil – Gas	1.933	No	Foreign	Yes
Carrefour	Supermarkets	1.870	No	Foreign	No
Ford	Automobile	1.815	No	Foreign	Yes
Phillip Morris	Tobacco	1.783	No	Foreign	Yes
Grupo Clarín	Media	1.769	No	Local	No
Disco	Supermarkets	1.601	Yes	Foreing	No
Cargill	Agribusiness	1.597	No	Foreign	Yes
Massalin	Tobacco	1.549	Yes	Foreign	Yes
Renault	Automobile	1.389	Yes	Foreign	Yes
Volkswagen	Automobile	1.381	No	Foreign	Yes
Cadesa	Supermarkets	1.375	No	Foreign	No
Perez Companc	Oil – Gas	1.308	Yes	Local	Yes
Fiat	Automobile	1.258	No	Foreign	Yes
Arcor	Food	1.240	No	Local	Yes
Siderar	Steel	1.231	Yes	Local	Yes
Coto	Supermarkets	1.223	No	Local	No
Lotería Nacional	Lottery	1.200	No	State	No
Molinos	Agribusiness	1.107	Yes	Local	Yes
Siderca	Steel	1.077	Yes	Local	Yes
Aerolíneas Argentinas	Airline	998	No	Foreign	Yes
Unilever	Cleaning	943	No	Foreign	Yes
Esso	Oil – Gas	877	Yes	Foreign	Yes
Edenor	Electricity	870	Yes	Foreign	No
Nobleza Piccardo	Tobacco	866	Yes	Foreign	Yes
Edesur	Electricity	864	Yes	Foreign	No
Deheza	Agribusiness	841	Yes	Local	Yes
Osde	Health Care	815	No	Local	No
Sancor	Food	801	No	Local	Yes
Droguería del Sur	Drugstores	798	Yes	Local	No
La Plata Cereal	Agribusiness	756	No	Foreign	Yes
La Serenísima	Food	745	No	Local	Yes
Mercedez Benz	Automobile	720	No	Foreign	Yes
Movicom	Telecommunications	719	No	Foreign	No
Astra	Oil – Gas	718	Yes	Foreign	Yes
Source: América Economía (Dow Jones), June 1999					

2. It has been proved by Carey, Prowse, et al (1993), among others scholars, that private placements convey suitable ways to cope with asymmetrical information overriding

most of corporations, and to tailor up huge bonds issues with complex contracts conveying plenty of covenants to reduce agency costs to bondholders. This seems to be a sensible explanation as to why there have been so many successful private placements in Argentina in the last decade.

3. A truly remarkable outcome of private placements for corporate governance lays on the Boards composition, because institutional investors look forward to seeing their representatives having a place there, as latest changes in argentine companies boards take place whenever investment funds enter them as stakeholders.

4. As regards as self-finance, it holds true and fits with the argentine context, that headquarters take profit of better credit ratings to issue securities in their own capital markets and redressing funds through their internal capital markets towards foreign branches.

Long-termism and Accountability

Either on bonds covenants or fiduciary requirements, private placements increase accountability from companies, but to the lenders' advantage. Therefore, it is more difficult for market analysts and credit rating agencies to assess management performance. Internal capital markets funding also impairs accountability as prevents information from being public.

On the other hand, as long-term finance is provided by private placements, the better chances we have of getting an strategic commitment with long-termism. To set things into perspective we have to be aware that in Argentina, however, the average term to maturity of debt in private placements doesn't stretch beyond ten years.

INSTITUTIONAL INVESTORS AND THE GOVERNANCE CONTEXT

As regards as this subject, we attach great importance to four issues:

i. Pensions Funds have not diversified their portfolios so as to voice their rights as independent directores or otherwise influencing companies.
ii. Mutual Funds and insurance companies, although more assertive towards covenants and minority rights, are still biased with short-termism.
iii. Among the Investment Funds population, we find a group of Financial Trust Funds that favours long-termism, but there is also a group of Capital Venture and Private Equity Funds which favour the short-termism side.
iv. Accountability and control should improve in this context.

a) Pension funds, mutual funds, insurance companies

Private pension funds have made an inroad for institutional investors in the capital markets, since they were allowed by law in 1994. However, the private system lives together with the State Pension System. Some 1999's statistics, from the government regulatory agency (Anses), can bring some perspective:

State System: in 1994 registered 2,764,036 contributors, while in 1999 only 2,011,997. In 1994, companies and government paid contributions to 2,150,475 employees, while in 1999 the amount dropped to 1,013,434.

Private System: in 1994 registered 3,033,506 contributors but paying their duties only 2,226,451. For 1999 there are 7,644,058 contributors enrolled but only 4,077,555 pay their duties.

It is worth looking at Table 7, just to weigh up the pension funds standing, since they came into existence. A sharp conclusion can be drawn from these figures: there is not yet a strong interest as minority rights holders.

To make a contrast, mutual funds (unit trusts) portfolios, as in June 1999, amounted to 8 billion dollars in market value, and insurances companies portfolios are assessed in 6 billions of dollars.

Table 7
Pension Funds Investment, as in June 1999 (in percentages)

Government Bonds	**48.31**
Private Bonds, long term	**01.63**
Private Bonds, short term	**00.64**
Saving Bank Deposits	**16.12**
Stocks	**15.95**
Mutual Funds	**06.27**
Privatized Companies	**04.02**

Source: SAFJP, June 99 Report
Market value: 13.536 billions of dollars.

b) Investment Funds

For the last four years, there has been a growing number of newcomers into the institutional investors field. Firstly, the insurance companies that will provide life insurance or retirement benefits to the pension system contributors, as stated by law. Secondly, two distinctive types of investment funds.

- ***Financial Trust Funds:*** they are allowed to make public offerings by the Trust Law (Law N° 24441), and their portfolios mainly consists of financial assets, securitized loans, real estate investments, and short-term commercial papers (in this case, they are suitable rolled-over so as to reach the span-life stated in the brochures). So far, these funds have issued almost 2,6 billions of dollars, and it is for the national Securities Commission to keep under surveillance and regulate this thriving market.

- ***Venture and Private Equity Investment Funds:*** As from 1998, a growing new investment field has become a driving force in the economy and the capital markets. We mean the Venture and Private Equity Investment Funds.

<u>Evidence:</u>

Table 8 can be helpful to give evidence of this growing concern in venture and private equity investment funds. A remark is due here: only a handful of funds are listed below. There are a lot more of them fully operational so far.

Table 8
Venture Capital and Private Equity Investment Funds

Investment Funds	Companies and Stock Share
Advent International (spread over 30 countries, owns 400 companies)	Universal Assistance (100%), Bodegas Graffigna (70%), Bodegas Santa Silvia (70%)
Bisa (Bemberg Group and foreign investors)	Caro Cuore (60%), Burger King (25%), Papel Misionero (50%), Barujel & Azulay (81%), Colorín (81%), Transfármaco (51%)
Global Investment	El Ateneo (100%)
Sabores Argentinos	Layco (100%), Po (70%), Tittarelli (70%)
The Exxel Group	Havana (100%), Casa Nine (100%), Coniglio (100%), Cahen d'Ánvers (70%), El Gurí (100%)
TW/Latin American Partners	Marta Harff (100%)
The Tower Fund	Inmobal Nurer (100%)

Source: La Nación, August 8, 1999

c) Governance

As governance is concerned, Financial Trust Funds foster stronger accountability from companies towards the market for corporate control, and improve the quality of investors' information. Besides, it is compulsory to be rated by private credit-rating agencies, and each Financial Trust Fund has to disclose mostly its life-span, as well any relevant information in their contracts and brochures.

On the other hand, Venture and Private Equity Investment Funds exhibit the following governance features:

~ Beyond a certain size, the company's owner places private stock or debt with a Venture Capitalist, which monitors the company and sometimes provides it with management. If success holds true, the fund's share rises and, most of the time, it goes on providing with management; and even buying the whole company.

~ The chance comes when the company can make a public placement of stock or debt. At this stage, it has developed a corporate governance structure drafted from outside the company's founder environment.

~ If the trend of financing small and medium companies with these investment funds is to last for a long time, a significative change in corporate finance would take place: from familiar, closely held companies, where the managing, control and ownership are knitted together, we are going towards small and medium companies which, before making their first public placement of debt or stock, keep management, control and ownership quite set apart.

5.- CONCLUSIONS

As we survey the last decade in Argentina, from the perspective of corporate governance and the capital market, three statements seem to hold true from the empirical evidence, which have been developed through this paper:

~ In Argentina, there has been a marked shift in corporate governance structure from big family-owned domestic companies towards foreign groups and investment funds ownership.

~ While coping with governance issues, Argentina has been performing as if followed the common law countries tradition.

~ The capital markets development has been nurturing contradictory forces which could bring about alternatives governance structures.

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