

An Empirical Analysis of Latin American Board of Directors and Minority Shareholders' Rights

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■ **ABSTRACT**

This paper examines the link between corporate governance structures and the potential for expropriation of minority shareholders' rights. Analysis of 97 firms from Brazil, Chile and Mexico that traded ADR shares in the United States between 2000 and 2002, indicates that increasing the size of the board by inclusion of additional independent outside directors lowers the potential for expropriation of minority shareholders' rights. Also, increases in the tenure of independent outside directors, decreases in CEOs' shareholdings and more interlocking directors on a board all serve to lower the potential for expropriation of minority shareholders' rights.

Keywords: Corporate Governance, Minority Shareholders' Rights, Board of Directors

■ **RESUMEN**

El artículo examina la relación entre las estructuras de gobierno corporativo y la posibilidad de expropiación de los derechos de los accionistas minoritarios. Se analizaron 97 empresas de Brasil, Chile y México entre el 2000 y 2002. Los resultados indican que el aumento en el tamaño de la junta de directores, al incluir directores externos independientes, baja la posibilidad de la expropiación de los derechos de los accionistas minoritarios. Además, a mayor tiempo de servicio en la junta de los directores externos independientes, a menor por ciento de propiedad de los CEOs y a más directores entrecruzados menor es la posibilidad de expropiación de los derechos de los accionistas minoritarios.

Palabras clave: Gobierno corporativo, Derechos de los accionistas minoritarios, Junta de directores, Política de pago, Dividendos, Readquisición de acciones

INTRODUCTION

Two factors may explain why minority investors are discouraged from investing in Latin American (LA) firms. First, controlling families are reluctant to trade companies' shares since this may result in the dilution of their power. Second, the weak legal environment gives rise to the potential for expropriation of minority shareholders' rights. These wealthy families possibly use corporate resources for their own interests while the minority shareholders bear the costs.

For example, in January 2000, a British mobile phone operator bought a minority stake in Iusacell, the Mexican mobile company, excluding small shareholders from the deal. The buyer acquired a 34.5% share directly from the controlling family, rather than offering to buy shares at the same price from minority investors.

Moreover, the LA business culture may enable some shareholders of LA firms to have significant control rights, in excess of their cash-flows rights, through the use of pyramids and by management participation in more than one business. These types of arrangements are known as *grupos económicos* (henceforth grupos) and are the dominant form of large private business organizations throughout the region. Typically controlling shareholders run grupos, not professional managers with little equity ownership.

Given the unique circumstances of LA markets, this paper empirically examines the link between the board of directors and the expropriation of minority shareholders' rights of firms in LA equity markets. Specifically, the paper addresses the following question: Is there a relationship between the board of directors' characteristics and the expropriation of minority shareholders' rights in LA firms?

This paper utilizes data from 97 companies from Brazil, Chile, and Mexico for fiscal years ending from 2000 through 2002 to answer this question. A panel analysis incorporating characteristics of firms' board of directors as well as a proxy for expropriation of minority shareholders' rights was used. The results provide empirical evidence that in Latin America as board size increases, through the inclusion of more independent outside directors, the potential for expropriation of minority shareholders' rights is reduced. Furthermore, the potential for expropriation is lowered as independent outside direc-

tors' tenure increases, as the CEOs' shareholdings decrease, and as more interlocking directors serve on the board.

The paper proceeds as follows. Section 2 discusses the empirical evidence of the relationship between board of directors and expropriation of minority shareholders' rights and frames the research question. Section 3 describes the data sources, sample selection, variables of interest and the descriptive statistics. The methodology utilized to test the hypotheses is presented in Section 4 along with the empirical results. Concluding remarks are presented in Section 6.

BACKGROUND

CORPORATE GOVERNANCE ENVIRONMENT IN LATIN AMERICA

Classic agency theory framework and corporate mechanisms do not apply to the circumstances of LA countries (La Porta, Lopez-De-Silanes, Shleifer & Vishny, 1998). Agency problems do not arise with the separation of owners and managers; instead, agency problems might stem from the misalignment of interests between majority and minority shareholders. Moreover, corporate governance mechanisms differ from those in developed economies: (a) It seems that boards of directors in Latin America are under the influence of controlling shareholders and do not perform their legitimate fiduciary duty to safeguard minority shareholders' interests; (b) ownership structure is concentrated in the hands of the controlling family or families; and (c) formal institutional protection is often lacking, corrupted, or not enforced. Looking at the LA scenario, the internal corporate governance mechanisms (board of directors and ownership structure) provide the opposite point from current research and may not provide the necessary protection as described by theory and suggested by the empirical evidence in developed economies.

BOARDS OF DIRECTORS

Boards of directors are the primary element of corporate governance, especially since they control many of the other mechanisms. The studies that examine the relationship between board characteristics and corporate performance address the effectiveness of the board in performing its monitoring function. The evidence, though mixed,

suggests that boards of directors play an important monitoring role (John & Senbet, 1998). The main empirical issue is proxing (or identifying an adequate proxy to measure) the degree of independence of a firm's board from its CEO. The adopted assumption is that the boards' characteristics (such as composition, size, and CEO duality) of boards are related to the degree of independence.

The degree of board of directors' independence affects the potential for expropriation of minority shareholders' rights. In general, as the degree of boards' independence increases, monitoring plays a more important role, while the opportunity for expropriation by majority shareholders is reduced; and vice versa. Nevertheless, this relationship may not exist in Latin America if incentives are lacking that make directors work on behalf of shareholders, i.e., market for corporate control and compensation.

Outside directors tend to perform diligently their duties, even when they have no financial stake in the company. Generally, outside directors are respected leaders from the business or academic community whose reputations suffer when associated with poorly performing companies (Fama, 1980; Fama & Jensen, 1983a; Weisbach, 1988). The need for monitoring is also expected when top management is composed of members of the controlling family, as in the case of Latin America. Therefore, it is expected that as the number of outside directors increases in LA boards, the possibility of minority shareholders' rights expropriation is reduced, due to the effective monitoring of such members.

Board size also plays a role in effective corporate governance. Researchers propose three main sources for board-size effects (a) increased communication and coordination problems, (b) board's decreased ability to control management, and (c) the cost of poor decision making spread among a larger group of firms (Eisenberg, Sundgren, & Wells, 1998; Yermack, 1996).

In Latin America, presumably little separation of ownership and control exists, invalidating the explanations arising from firms in developed economies. Still, it is expected that as the size of the board of directors increases, the potential for expropriation also increases because communication and coordination problems may exist, as it is a behavioral phenomenon.

In a typical large LA firm, the CEO usually is part of the controlling family; therefore, his/her influence over the board of directors may hamper the board's independence. For example, in Mexico, Babatz Torres (1997) reports CEO duality, where the CEO is also the President of the board, in 85 percent of the firms trading shares at the NYSE in 1996, and in practically every case the same individual is the largest shareholder. Therefore, whenever a firm has a dual leadership and/or the longer the tenure of the CEO, higher expropriation of minority shareholders' rights is expected. At the same time, as the outside director's tenure increases, his/her monitoring role increases and the potential for expropriation of minority shareholders' rights decreases.

Weisbach (1988) presents evidence that CEOs with more share ownership have increased power in the firm. This may provide an incentive to exclude outsiders from a board. A complementary argument, from Jensen and Meckling (1976), is that when owner-managers' shareholdings grow as a fraction of their wealth, their interests become more aligned with the firm's shareholders. Therefore, as the CEO ownership increases the potential for expropriation of minority shareholders' rights might also decrease.

In Latin America, directors usually are well-known businesspeople who serve on more than one board of directors, usually from the same grupo. Their multiple directorships help to establish the necessary links to survive in the less-developed market that surrounds LA businesses. For instance, Husted and Serrano (2002) find that in a sample of the 90 largest Mexican companies, only 16 have no interlocking directors, and these firms tend not to belong to any grupo.

Moreover, in emerging markets given the limited pool of possible individuals that can become outside directors these interlocking directors become more valuable. The expertise of these outside directors increases their value. Since many of the firms in LA are connected directly or indirectly through business grupos, pyramids, and family relationships, it is expected that there is a limited pool of individuals that may serve as directors. Hence, as the number of interlocking directors increases in a board, the expropriation of minority shareholders' rights is expected to decrease.

In sum, the different characteristics of boards of directors indirectly affect the potential for expropriation of minority shareholders' rights.

Such characteristics influence the degree of independence of boards, which in turn, have a direct effect on the expropriation of minority shareholders' rights. Therefore, a negative relationship is expected between the measures of board independence and the expropriation of minority shareholders' rights.

DATA

The sample includes LA companies with shares traded on U.S. exchanges as American Deposit Receipts (ADRs).¹ These foreign companies trade under the regulations of the U.S. Securities Exchange Commission (SEC), which require foreign firms to annually disclose a set of information (Form 20-F) including the composition of the board of directors and financial statements, among other items. The data sources for 20-F forms were *Lexis®-Nexis® Academic Universe*, the individual company's web pages, and the SEC EDGAR service.

Previous research on emerging economies dealing with the expropriation of minority shareholders' rights employs one year data, primarily due to data gathering constraints. However, this study utilizes three years of data, fiscal years ending from 2000 through 2002, resulting in one of the larger LA samples among the existing research.

At the end of 2002 there were 110 LA companies with ADRs listed on U.S. exchanges, with firms from Brazil, Chile, and Mexico accounting for 76 percent of these. The final sample includes 269 observations representing 97 firms divided by countries as follows: Brazil (34), Chile (28), and Mexico (35).

Most data necessary to construct the variables for the analyses is extracted from the Form 20-F, with the exception of some of the relationships among the owners which was obtained from other sources such as the company web pages. Also, the control variable for company size was obtained from *Datastream*.

¹ For robustness, a convenience sample of 14 Mexican companies not trading ADRs was analyzed and t-tests of differences between the (or means differences) found no significant difference between the Mexican ADR firms included in the sample and the non-ADR firms.

DEPENDENT VARIABLE - EXPROPRIATION OF MINORITY SHAREHOLDERS' RIGHTS

Measuring expropriation of minority shareholders' rights can be difficult given its numerous definitions and manifestations. However, emerging markets research suggests that concentrated ownership is correlated with a lack of investor protection (Claessens, Djankov, & Lang, 2000; Denis & McConnell, 2003; La Porta, Lopez-De-Silanes, & Shleifer, 1999; La Porta et al., 1998; Shleifer & Vishny, 1997).

This study utilizes the Herfindahl index (HI) to measure ownership concentration and as a proxy for the expropriation of minority shareholders' rights. This index captures both the inequality of shares among stockholders and the number of shareholders as well as better reflecting the true levels of ownership concentration in any company (Barabanov & McNamara, 2002). The HI is usually calculated as the sum of squares of the shareholdings of the top ultimate share blockholders holding at or above the five percent level.

To calculate the HI, the ultimate ownership of both direct and indirect control and cash-flows rights of each firm in the sample was traced for each of the three years (2000 – 2002) under consideration. To do so, the direct ownership of control rights for all owners with stakes at or above a five percent threshold was determined. Then the ultimate control of these direct owners was traced, using the same threshold of five percent ownership. Form 20-F usually traces the identity of ultimate control owners with at least five percent ownership. Where Form 20-F did not provide the necessary information for determining the ultimate owners, other sources of information were utilized, such as the web pages of the companies.

Once these ultimate owners are identified, control rights are determined for the sample company and categorized into one of the following groups: family-management ownership group, non-affiliated company ownership group, government ownership group, institutional ownership group, individual ownership group, and miscellaneous ownership group, following Lins (2003). Once the ownership group of each firm was classified, the HI index was based on the holdings of the owners in each group. The total HI was calculated across the six ownership groups as the sum of squares of each owner group l 's number of shares as a proportion of total shares outstanding (*EXPROPRIATION*).

INDEPENDENT VARIABLES

Using the traditional classification of directors proposed by Baysinger and Butler (1985), members of a board were classified as inside directors, affiliated outside directors (“gray directors”) or independent outside directors. Outside directors (*OUTSIDERS*) were the independent outside directors, excluding the affiliated outside directors. Once the classification is made, the following alternative measures of board composition are determined for each of the three years under consideration: (a) total number of outside directors to board size (*OUTSIDERS TO SIZE*); (b) percentage of outside directors to inside directors (*OUTSIDERS TO INSIDERS*); and (c) percentage of inside directors to board size (*INSIDERS TO SIZE*). The size variable (*BOARD SIZE*) will represent the total number of active board members reported in the company’s annual Form 20-F for the periods ending 2000 - 2002.

For every outside director and the CEO, the number of years in the position is determined from the biographical description provided in the Form 20-F. Thus, the following two tenure measures are calculated: 1) total years of CEO in that position (*CEO TENURE*), and 2) the aggregate average tenure of outside directors (*OUTSIDERS TENURE*). In addition, for every CEO his/her equity ownership was calculated to determine: 1) percentage of CEO ownership (*CEO OWNERSHIP*).

Finally, the number of interlocking directorates (*INTERLOCKING*) on a board was determined by reading the bibliography or personal description² of each member. An individual serving on the board of another company that is part of the grupo will be considered as having an interlocking directorate.

Control variables are included in the models to account for differences in company size (*COMPANY SIZE*), industry, age (*LN_AGE*), and dual-class shares. A dummy variable (*SHARE DUALITY*) controls whether or not the company issues dual-class shares.

² The bibliographical descriptions sometimes were missing or too vague (*this director serves on several boards of other companies*) without mentioning the specific company of the interlocking directors. Therefore, this measure was constructed taking into account only the directorships among the companies sampled.

DESCRIPTIVE STATISTICS

Table 1 summarizes the descriptive statistics for the 269 observations that comprise the whole sample as well as separated by country (for all years combined). On average, LA companies have nine members on their board of directors, of whom eight are insiders. Note that 40.5 percent of the observations had no outside directors serving on the board, indicating companies dominated and controlled by families. Mexican companies tend to have larger boards, 11 members on average, in comparison with their counterparts in Brazil and Chile, with an average of eight members.

TABLE 1
DESCRIPTIVE STATISTICS, MEANS BY COUNTRY
(STANDARD DEVIATION IN PARENTHESES)

Variable	All	Brazil	Chile	México
EXPROPRIATION	39.08% (26.00)	37.31(25.78)	32.87(23.28)	45.55(26.96)
OUTSIDERS	1.42(1.68)	1.30(1.44)	1.47(1.86)	1.50(1.77)
INSIDERS	8.29(3.52)	7.63(3.06)	6.62(2.22)	10.19(3.86)
BOARD SIZE	9.72(3.62)	8.93(3.56)	8.08(1.53)	11.69(3.9)
CEO TENURE	8.13(8.91)	5.82(6.15)	5.04(3.82)	12.85(11.64)
OUTSIDERS TENURE ^a	2.65(4.5)	1.61(2.02)	2.32(2.69)	3.90(6.59)
CEO OWNERSHIP ^b	7.43%(16.8)	2.15(7.78)	0.857(2.11)	17.48(23.55)
INTERLOCKING	2.06(2.21)	1.60(2.15)	1.89(1.83)	2.62(2.41)
OUTSIDERS TO SIZE	14.40%(16.8)	13.00(13.6)	18.10(21.8)	12.80(14.9)
INSIDERS TO SIZE	85.60%(16.77)	86.95(13.61)	81.89(21.82)	87.17(14.93)
OUTSIDERS TO INSIDERS	27.68%(75.97)	18.19(20.82)	50.74(137.02)	19.70(31.11)
COMPANY SIZE	8.51(1.33)	8.65(1.31)	8.02(1.02)	8.71(1.45)
AGE	3.18(1.15)	27.18(24.34)	64.93(38.24)	32.22(25.24)
GRUPO	0.74	0.72	0.96	0.57
SHARE DUALITY	0.24	0.14	0.07	0.48
BANK	0.15	0.10	0.23	0.12
CONSTRUCTION	0.01			0.03
MANUFACTURING	0.35	0.27	0.36	0.44
SERVICES	0.01	0.03		
TRADE	0.08	0.03	0.14	0.09
TRANSPORTATION	0.30	0.45	0.12	0.29
UTILITIES	0.07	0.09	0.15	
N	269	98	73	98

Note. N= number of companies. ^an = 268; 1 missing value for Chile. ^bn = 266; 2 missing values for Chile, and 1 missing value for Mexico.

The CEOs in the sample have served in their position for eight years in comparison with less than three years (2.68 years) for outside directors. The tenure of CEOs (12.9 years) and outsider board members (3.9 years) from Mexico is longer than those from either Brazil (5.8 and 1.6 years) or Chile (5.0 and 2.3 years) for CEOs and outsiders, respectively.

The CEO is also the Chairman of the board in 19 percent of the observations. This contradicts the profile in the U.S., with Brickley, Coles and Jarell (1997) reporting a combined leadership rate in U.S. companies between 70 and 80 percent. CEOs only own 7 percent of shares on average when considering the whole sample. CEOs with Mexican companies have the largest proportion of ownership with 17 percent. A possible explanation for the low equity ownership is that LA companies are hiring professional CEOs to manage the firms. In fact, in 29 percent of the sampled companies, the CEO was part of the controlling family. However, this is consistent with CEO duality, with Mexican firms also having both a higher proportion of CEO duality and a higher proportion of CEOs from the controlling family. In Mexico, where more CEOs are also the Chairmen of the board and part of the controlling family, it is not surprising to see that they own a larger portion of the firms.

The alternative board composition measures also reflect the reality of inside directors' dominance on the board of directors. On average, there are 14.4 percent of outside directors to total directors; 27.7 percent of outside directors to inside directors, and 85.6 percent of inside directors to total directors. Chile exhibits the highest proportion of outsiders to both insiders and total directors, with 50.1 and 18.1 percent, respectively. This may suggest that Chilean firms may be adopting better corporate governance practices, such as bringing more outside directors to the boards. However, a different story appears upon examination of the annual trend of this variable, which decreases between 2000 and 2002.

Firms included in the sample have a mean expropriation index of 39.1 percent. From the sampled countries, Mexican companies have the highest potential of expropriation of minority shareholders' rights with an index of 45.5 percent, followed by Brazil with 37.3 percent

and Chile with 32.9 percent. These indexes are consistent with prior research in emerging economies (i.e. Lins, 2003).

The majority of the sample has grupo affiliation (74 percent), with Chile (96 percent) the country with the highest proportion of grupo affiliation, followed by Brazil (72 percent) and Mexico (57 percent). The size of the companies in the sample is fairly consistent across the three countries as is their market value. The relatively young age of Brazilian companies may be a reflection of newly formed companies being included in the sample. These new companies are the result of the privatization of cellular telecommunications in Brazil in 1998 that resulted in 12 new companies.

EMPIRICAL ANALYSIS

We first employed univariate analysis to determine whether the means of the dependent and independent variables are equal across countries. The analysis indicated that board characteristics differ among the Chilean, Brazilian and Mexican firms.³ Thus, additional analysis was undertaken to determine if indeed the differing board of directors' characteristics leads to expropriation of shareholder rights. To do so, panel analysis was utilized since it allows for the consideration of both the cross-sectional and time-series effects in the sample, and helps in identifying the sources of possibly mingled effects.

To measure the relationship between the potential for expropriation of minority shareholders' rights and each the characteristics of the board of directors and the firm's ownership structure, the following specific model was estimated:

$$Expropriation_i = \alpha_0 + \sum_{k=1}^m \alpha_1 Board_{ki} + \sum_{j=1}^n \alpha_2 Control_{ji} + e_i \quad (2)$$

where

- Expropriation* = Ownership concentration measure of company i,
- Board* = Characteristics of company i's board of directors
- Control* = Control variables j for company i

³ Results of the ANOVA and Scheffé analyses are available from the authors.

Table 2 presents the results of estimating the model and, in general, the results show that as board size increases, through the inclusion of more independent outside directors, the potential for expropriation of minority shareholders' rights is reduced. The potential for expropriation is decreased further as the tenure of independent outside directors increases, as the CEOs' shareholdings decrease, and as more interlocking directors serve on the board.

TABLE 2
PANEL RESULTS – RANDOM-EFFECTS FULL FEASIBLE GLS ESTIMATION

Dependent Variable = EXPROPRIATION	Coef.	Standard Error	P> z
Constant	0.32 ***	0.03	0.00
Board of Directors Characteristics			
OUTSIDERS TO SIZE	0.76 ***	0.15	0.00
LN BOARD SIZE	0.03 **	0.01	0.01
OUTSIDERS TO SIZE * LN BOARD SIZE	-0.41 ***	0.07	0.00
LN CEO TENURE	0.002	0.004	0.59
LN OUTSIDERS TENURE	-0.01 **	0.005	0.03
CEO OWNERSHIP	0.39 ***	0.03	0.00
INTERLOCKING	-0.03 ***	0.002	0.00
Control variables			
COMPANY SIZE	0.04 ***	0.003	0.00
GRUPO	-0.11 ***	0.02	0.00
SHARE DUALITY	-0.01	0.01	0.24
LN_AGE	-0.01 **	0.004	0.02
CONSTRUCTION	-0.31 ***	0.01	0.00
MANUFACTURING	-0.13 ***	0.01	0.00
SERVICES	-0.11 ***	0.02	0.00
TRADE	-0.01	0.02	0.48
TRANSPORTATION	-0.24 ***	0.01	0.00
UTILITIES	-0.18 ***	0.03	0.00

N = 95 companies; 264 observations. Prob > $\chi^2 = 0.0000$. ***, ** and * denote significance at 1%, 5% and 10% level, respectively.

We theorized that as the number of independent outside directors on a board is reduced, there is an increased potential for the expropriation of minority shareholders' rights. However, the mere inclusion of

independent outside directors on a board does not appear to lower the potential for expropriation of minority shareholders' rights since the coefficient of the variable *OUTSIDERS TO SIZE* is positive and statistically significant. Thus, the traditional monitoring role of outside directors seems to be either not present or ineffective in LA companies.

Next we posit that a larger board size leads to increased potential for expropriation of minority shareholders' rights. The positive and statistically significant coefficient of the variable *LN_BOARD SIZE* indicates that larger boards increase the potential for expropriation. This finding supports the argument that there is less communication and more coordination problems arising as more people make decisions (Eisenberg et al., 1998; Yermack, 1996). These problems lead to an ineffective monitoring and control of management and board of directors, since bigger groups are more difficult to manage. Moreover, CEOs tend to prefer larger boards due to the less candid discussion of managerial performance (Jensen, 1993).

To further explore the positive relationship between the mix of outside directors to total board size to the potential for expropriation of minority shareholders' rights an interaction term (*OUTSIDERS TO SIZE * LN_BOARD SIZE*) is included. The interaction term is statistically significant and negative. In other words, when the number of directors serving on a board grows because of the inclusion of additional outside directors, there is a decrease in the expropriation of minority shareholders' rights. This interaction term suggests that LA companies are increasing their boards' size to accommodate the outside directors without sacrificing seats allocated to family members. In addition, these outside directors perform their monitoring duty more effectively as they find other outside directors in the same board. The mere inclusion of an outside director into a small board may not improve the minority shareholders' situation. However, inclusion of several outside directors may provide a safer environment for the minority shareholders.

The incentives that make outside directors work on behalf of minority shareholders, such as the market for corporate control or compensation, are lacking in Latin America. However, these individuals desire to safeguard their reputations. LA companies may be including respected leaders from the business or academic community

that will diligently perform their duty even if they have no financial stake in the company to avoid harming their reputation associating with poorly performing companies (Fama, 1980; Fama & Jensen, 1983a; Weisbach, 1988).

The coefficient for *LN CEO TENURE* was positive but not statistically significant. Gibson (2003) found, in emerging markets, no link between CEO turnover and performance in the presence of large domestic shareholders. Thus, in emerging markets such as Latin America, the CEO actions or tenure may not affect other aspects of the firm, such as performance or corporate governance, as occurs in developed economies. Furthermore, although the CEO can gain power the longer he/she is in the position, it may be mitigated by the controlling power of the family and other inside directors.

The negative and statistically significant coefficient of *LN OUTSIDERS TENURE* that supports a negative relationship between the independent outside directors' tenure and the potential for expropriation of minority shareholders' rights, was expected and is consistent with previous results on the monitoring role of outside directors ((Mishra & Nielsen, 2000). The longer an outside director serves on a board of directors, the lower the potential for expropriation of minority shareholders' rights.

The coefficient of the *CEO OWNERSHIP* variable is positive and statistically significant, indicating a higher potential for expropriation of minority shareholders' rights. Thus, CEOs' shareholdings appear to reduce the level of monitoring that may negatively affect minority shareholders, without the presence of other internal corporate governance mechanisms. This finding supports the classic agency theory argument that when managers' shareholdings grow as a fraction of personal wealth, their interest becomes more aligned with the majority shareholder-owner (Jensen & Meckling, 1976; Weisbach, 1988). Thus, as LA CEOs shareholdings increase, their objectives more closely match those of the controlling family, and minority shareholders may lose an important monitoring device for good corporate governance. This supports the findings of Gibson (2003) who showed that minority investors in emerging markets controlled by a large shareholder, i.e. family, should be aware that managers may favor the large shareholder at the expense of the minority shareholders.

Finally, we expect that the lower the number of interlocking directorates on a board of directors, the higher the potential for expropriation of minority shareholders' rights. The negative and statistically significant coefficient of *INTERLOCKING* shows the anticipated relationship between the number of interlocking directorates on a board of directors and the potential for expropriation of minority shareholders' rights. Therefore, including interlocking directors on LA boards may reduce the potential for expropriation of minority shareholders' rights. The rationale for this finding rests on the same argument that CEOs benefit when they serve as outside directors in other firms. In emerging markets, interlocking directors, whether or not they are also the CEOs, become more effective in their monitoring role as they serve in other boards, thus decreasing the potential for expropriation of the minority shareholders' rights. Interlocking directors internalize efficiencies from the diverse firms they serve.

Minority shareholders may consider these findings to be robust across all industries relative to financial institutions, with the exception of trade. The coefficients of the company size (positive), grupo affiliation (negative), and age (negative) are also statistically significant suggesting that minority shareholders should exercise caution when investing in younger and/or bigger companies and/or affiliated with a grupo. Finally, it appears that the use of dual-class shares may not lead to more expropriation of minority shareholders' rights as reported by Nenova (2003).

CONCLUSIONS

The distinctive characteristics of LA markets provide a unique scenario to expand research on corporate governance. First, the misalignment of interests between majority and minority shareholders is the root of agency problems, not the divergence between goals and objectives of management and owners. Second, corporate governance mechanisms to alleviate agency problems are inefficient or non-existent. Third, weak legal environment enhances the potential of agency problems, especially the expropriation of minority shareholders' rights. Therefore, the purpose of this work is to empirically examine the link between the characteristics of firms' boards of direc-

tors and the expropriation of minority shareholders' rights of firms represented in LA equity markets. We find empirical support for this relationship. It appears that as the number of directors serving on a boards increase through the inclusion of additional independent outside directors, the potential for expropriation of minority shareholders' rights is decreased. Also, increases in the tenure of independent outside directors, decreases in CEOs' shareholdings and more interlocking directors on a board all serve to reduce the potential for expropriation of minority shareholders' rights.

As in all studies, this research has its limitations. The narrow sample period (although larger than others looking at Latin America) is one of the weak points of the analysis. Observations spanning over only three years may not be representative of the relationship between corporate governance structure and expropriation of minority shareholders' rights, hindering the general applicability of the results. The use of only three countries may also be considered as a similar shortcoming. Nevertheless, the present work sheds light into an unexplored area in finance.

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