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Essays on Corporate Law, Governance and Development in the Pacific Alliance

By

Alvaro En Pereira Pacheco

A dissertation submitted as part of the requirements

for the degree of

Doctor of the

Science of Law

of the

University of California, Berkeley

Committee in charge:

Professor Steven Davidoff Solomon, Chair

Professor Stavros Gadinis

Professor Barry Eichengreen

Summer 2020

Essays on Corporate Law, Governance and Development in the Pacific Alliance

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Abstract

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The Pacific Alliance is an economic block formed by Chile, Colombia, Mexico, and Peru in 2011. Driven by the shared goal of accelerating economic development through market liberalization and the preeminence of both democracy and the rule of law, it has gradually established common economic policies and institutions, including a venture capital fund and an integrated stock exchange—the *Mercado Integrado Latinoamericano* (MILA). Despite these and other accomplishments, corporate law and governance remain within the jurisdictional borders of the Alliance's member States. This context offers a unique opportunity to critically review and test contemporary accounts on the extent to which corporate law and governance can contribute to economic development by promoting three objectives: sustainable corporate practices, entrepreneurship, and private firms' access to external finance.

This dissertation comprises three essays, each of which uses a different method—functional legal analysis, econometrics, and leximetrics, respectively—to dissect these questions individually. Together, they demonstrate that, beyond the regulation of entry and shareholder protection, corporate law and governance can induce meaningful changes to corporate behavior with an impact on economic development determinants. The essays also attest that the Pacific Alliance has not done enough to promote these objectives.

To my family, for their unconditional love and support, and my mentors, for inspiring me to pursue a meaningful life in academia.

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Preface

"Front desk jurisprudence" is a common expression among Colombian lawyers. It refers to rules that civil servants in courthouses and other government offices follow to process new filings. These rules are not legal. In fact, they are often unwritten and fluctuate with legal operators' preferences, not with policy objectives. Some of these rules are benign, such as the ones that determine the order of pages; others are less so, requiring personal filing or pre-approval from other public authorities. Most people—including policymakers—do not know about them or the inefficiencies (and injustices) that they conceal. And aspiring attorneys are only exposed to them in their last year's mandatory pro bono practice. Those who learn how to reconcile the contradictions between these rules and the legal system have a strategic advantage in the legal profession. But those are the minority. For the rest, the law is written and justice is blind.

Like "front desk jurisprudence," Latin American corporate law and governance has evolved in the shadow of society, with unobserved and unintended consequences. The first corporate statutes were transplanted from the jurisdictions where the modern business enterprise originated in North America and Europe, and preserved almost intact for decades. While many of the transformative events of the twentieth century forced shifts in governments and inspired new Constitutions in the region, the rules that govern how corporations are created and managed did not experience meaningful changes. And when they did, changes were cosmetic or limited in scope, as evidenced in the reforms that accompanied the privatization of state-owned enterprises in the 1990s. The law—corporate law—remained blind, but to its own undefined goals and to society's aspirations.

The three essays comprising this dissertation address this pervasive disconnection between corporate law and governance, on the one hand, and economic growth and development, on the other.

I first started reflecting on these issues with my father, during my mandatory pro bono practice in Bogotá. An indefatigable lawyer and educator who lived through these developments, he helped me canalize my amusement and occasional dismay with the "law in action" into an elevated sense of social responsibility and an appreciation of the value of an ethical life. Our discussions made me a better lawyer and thinker. Most importantly, they convinced me that there were various ways in which I could contribute to solutions while growing as an individual, including legal scholarship. It is a debt that I will never be able to pay but that I aimed to honor by enrolling at Berkeley Law and committing to be the first one in my family to pursue a career in academia.

With time, it became apparent to me that the relationship between law and development had troubled academics and policymakers for years. My intention to inquire how corporate legal institutions' affect development determinants was, hence, neither novel nor particularly interesting. Yet, to my fortune, this compilation of essays was conceived at Berkeley, through conversations with Professor Robert D. Cooter. Our meetings resembled a Platonic dialogue, at best, and an oral examination, at worst. That is, at least, how I recall most of them, although, in fairness, we also discussed the meaning of life and ideas, over coffee, without any academic framework. Despite his deteriorating health (and for reasons that I still wonder), he supervised my LL.M. thesis and served as my chair during my first years in the J.S.D. program. His book, *Solomon's Knot: How the Law can End the Poverty of Nations* (coauthored by Hans-Bernd Schäfer) had a significant influence in my thinking about legal institutions and economic development. Chapter Four of this dissertation, *Economic Freedom in the Pacific Alliance's Corporate Law*, which I expect to be the first of a series of studies on the law and finance of private corporations, relies on the method introduced by Bob Cooter and Tom Ginsburg in the early 2000s. I am therefore immeasurably grateful to him.

I also owe immense gratitude to the members of my dissertation committee, each of whom trusted and supported my research and personal growth. Professor Barry Eichengreen taught me the significance of empirical research, opening the door to a new universe of ideas. Without his input and patient guidance, this project and—literally—my career would look entirely different. Through detailed criticism, Professor Stravos Gadinis also steered my approach to corporate legal institutions in crucial moments. And Professor Steven Davidoff Solomon supported me even before formally joining my committee. Under his leadership, the Berkeley Center for

Law and Business has become a global referent. He generously welcomed my participation in numerous seminars, conferences and executive programs that shaped my research agenda even beyond these essays.

At Berkeley Law, other scholars and friends also supported me. Professors Zenichi Shishido, Laurent Mayali, Richard Buxbaum, Joshua Cohen, Jan Dalhuisen, Robert Bartlett, Bruno Salama, and Amelia Miazad, discussed with me the themes that I address in these essays at different stages. My friends and colleagues Karen Seif, Huantin Hu, Sebastián Bravo, George Lambeth, Kentsuke Tsujimoto, and Michel Kertai provided insightful comments and criticism to earlier drafts and ideas. And Evelyn Borchert, associate director of Berkeley Law's International & Advanced Degree Programs, tirelessly and selflessly offered me her kind support when I most needed. I am thus thankful to each of them.

Albeit methodologicallly divergent, the three essays compiled in this dissertation commit to a comparative approach to corporate law and governance. It is one component that has not change but one where my thinking has significantly evolved. I am extremely fortunate for the mentorship of Professor Luca Enriques, at the University of Oxford, Faculty of Law, who has helped me nurture a better understanding of the virtues and perils of this type of legal scholarship. With his trust and support, I have spent the last eighteen months as a Junior Academic Visitor at the University of Oxford; first, at its Faculty of Law, and, then, at the Commercial Law Centre at Harris Manchester College (CLC). During this period, I have also benefited from discussions with Professors Kristin van Zwieten, director of the CLC, and from the support provided by Geneviève Helleringer, and Horst Eidenmüller, all of whom welcomed me as an Associate Editor of the Oxford Business Law Blog. At Oxford, I have discussed parts of this project with several colleagues and friends, including Georgios Pantelias, Lukas Vossen, Dimitrios Kafteranis, Katarzyna Parchimowicz, Edoardo Martino, and Edmond Toma. Jonathan Chan's advice was particularly significant when designing the Code Book for the *Leximetrics* analysis in Chapter Four. Crescente Molina, whom started this journey with me in Berkeley Law five years ago, has generously listened to—and criticized—my ideas in countless occasions in California and in the United Kingdom, helping be become a better thinker. To all of them, I am indebted.

For supporting my ideas and personal development, I would like to thank the team at the Berkeley Center for Law and Business (in particular, its executive director, Adam Sterling), the Miller Institute for Global Challenges and the Law, and

Italia Innovation, a groundbreaking program on entrepreneurship that allowed me to exchange thoughts with founders and CEOs of thriving companies in Italy. My understanding of the issues that I explore in all three essays benefited from those discussions, as well as from conversations with Robert Strand, from the Haas School of Business, and Vincent Stanley, from Patagonia.

For financial support, I want to express my gratitude to the program Bolivar Gana con Ciencia, administered by Fundación CeiBA. For research support, I am also grateful to Andrés Daza Pacheco, Confederación Colombiana de Cámaras de Comercio (Confecamaras), the libraries at Saïd Business School, University of Oxford, and Haas Business School at UC Berkeley. I am particularly appreciative for the support of James Church at UC Berkeley's Library and Marci Hoffman at Berkeley Law's Library, as well as to the organizers and participants of the Junior Academic Visitors Workshop at Harris Manchester College, University of Oxford, the XXII Meeting of the Latin American Law and Economics Association, the 2018 SJD Roundtable at Georgetown Law Centre, the International Conference on Culture, Institutions and Regional Economic Development at Matera, Italy, the Empirical and Socio-legal Studies Workshop at the University of Oxford, Faculty of Law, and the Cambridge Handbook Symposium at the University of Oslo. My gratitude also goes to Professors Beate Sjåfjell and Christopher M. Bruner, the editors of the Cambridge Handbook on Corporate Law, Corporate Governance and Sustainability, where Chapter Two of this dissertation was included.

As this journey comes to an end, it has become clear to me that, while ideas are the result of a collective effort, one cannot avoid the responsibility that comes when expressing them in written words. Therefore, I want to apologize to anyone I have mistakenly forgotten and release my mentors, colleagues, and friends from any remaining errors in these essays.

Over a decade has passed since the first discussions I had with my father and almost five years since my first meeting with Bob Cooter. While we all expected the world to change, no one anticipated a pandemic to alter social life indeterminately, as it happening while I write these words. The sudden spread of COVID-19 and the uncertainty about its lasting impact uncovered the weak foundations of the institutions that support markets and democracies. It is a reminder that our societies are a work in progress and that the "front desk jurisprudence" development of corporate law and governance looms our aspirations of a more prosperous and fair future. Hence, I envision these essays as my first contribution to

strengthening the nexus between the evolution of legal institutions and social objectives—a first in a life-long commitment to keeping this nexus out of the shadow, just as my mentors have done.

Oxford

August 2020

Chapter One

Introduction

On April 28, 2011, the heads of State of Chile, Colombia, Mexico, and Peru gathered in Lima to formalize their intention to create a new economic bloc, the Pacific Alliance.[1] The process acquired formal legal status in June 6, 2012, with the signature of the Framework Agreement, the Alliance's constitutive Treaty,[2] fully binding since its ratification by all signatories on July 20, 2015.[3] The economic integration advanced at an unprecedentedly rapid pace, even before ratification and despite a history of futile attempts to create political unions in Latin America.[4] In

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[1] PACIFIC ALLIANCE, *Declaración de Lima, Cumbre de Lima para la Integración Profunda* (April 28, 2011) http://www.sice.oas.org/TPD/Pacific_Alliance/Presidential_Declarations/I_Summit_Lima_Declaration_s.pdf (last visited July 2, 2020)

[2] PACIFIC ALLIANCE, *Framework Agreement*, art. 1 (June 6, 2012) http://www.sice.oas.org/Trade/PAC_ALL/Framework_Agreement_Pacific_Alliance_s.pdf (last visited July 2, 2020) (The parties hereto constitute the Pacific Alliance as an area of regional integration").

[3] In addition to the signature, ratification required fulfillment of domestic procedures. On July 20, 2015, the Colombian Constitutional Court declared the constitutionality of the Treaty, which was the lasting ratification requirement. *See* SECRETARÍA DE RELACIONES EXTERIORES DE MÉXICO, *Acuerdo Macro de la Alianza del Pacífico Entra en Vigor* (July 20, 2015) http://saladeprensa.sre.gob.mx/index.php/es/comunicados/6457-387 (last visited October 10, 2019) *See also* PACIFIC ALLIANCE, *Framework Agreement*, art. 13 (establishing the special conditions for ratification); and Vienna Convention on the Law of Treaties, May 23, 1969, art. 14 ("The consent of a State to be bound by a treaty is expressed by ratification when: (a) the treaty provides for such consent to be expressed by means of ratification").

[4] *See* Carlos Malamud, *Regional Integration and Cooperation in Latin America: Diagnosis and proposals*, 7 GLOB. J. OF EMERGING MKT ECON. 92, 97 (2015) (noting that "[t]he weakness of the current integration process can be seen from a number of angles. Several interpretations are made from a clearly discursive, mainly political, stance, with a self-exculpatory purpose... Another explanation is that integration is failing to progress because of the frontal opposition of outside forces.. current regional fragmentation proves is that it is more difficult than in the past to make most countries agree regarding certain issues on the international agenda...By attributing the lack of success to the novelty of the process or to foreign conspiracies, the debate on the current state of integration is delayed indefinitely."). For an overview of a similar, yet slower and more challenging integration process in Latin America, MERCOSUR, *see* Jaime Behar, *Economic Integration and Economic Divergence*, in COOPERATION AND COMPETITION IN A COMMON MARKET: STUDIES ON THE FORMATION OF MERCOSUR 103-119 (Jaime Behar 2012). For a review on the relative exceptional case of the Andean Community, *see* Laurence Helfer, Karen J. Alter, & Florencia Guerzovich, *Islands of Effective*

less than a decade, virtually all restrictions to the movement of people, goods, services and capital were lifted, [5] and fifty-nine nations joined the Alliance as signatories observer States.[6]

These results have been possible due to a shared approach towards economic growth and development, which, according to the Framework Agreement, shall be achieved through market liberalization and the preeminence of both democracy and the rule of law.[7] While not conceptually novel, this approach is demonstrative of a serious commitment to market-driven growth, which should not be taken for granted in Latin America. Despite changes in governing political parties[8] and the strengthening of an opposing ideological trend in the region,[9] all four Pacific Alliance Member States (PAMS) have consistently implemented a variety of policies favoring private markets for over twenty years. PAMS are not only Latin America's most thriving open economies, [10] they also share a history of privatization reforms,[11] are part of crucial free-trade-oriented organizations,[12] and are parties to

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International Adjudication: Constructing an Intellectual Property Rule of Law in the Andean Community, 103 AJIL 1 (2009)

[5] JASON MARCZAK & SAMUEL GEORGE, PACIFIC ALLIANCE 2.0, 4 (2016); and Jaime García, *Alianza del Pacífico, ¿Hacia dónde vamos?*, 31 AGENDA INTERNACIONAL 43 (2013)

[6] An updated list of available at https://alianzapacifico.net/en/observant-countries/#:~:text=At%20the%20XIV%20Summit%20of,new%20Pacific%20Alliance's%20Observer%20States (last visited July 2, 2020)

[7] PACIFIC ALLIANCE, *Framework Agreement*, arts. 2-4.

[8] SAMUEL GEORGE, THE PACIFIC PUMAS, 14-19 (2014)

[9] In the wake of the twenty first century, Venezuela, Argentina and other South American economies, advanced policies strengthening state control over private initiatives, such as limits to currency exchange and foreign investments. This new wave of protectionism got to capture the interest of bigger and smaller economies, such as Brazil or Uruguay, and increased its political influence thanks to the support of another regional bloc, MERCOSUR. For an overview of that trend, *see* Oliver Cadot, Jaime De Melo & arcelo Olarreaga, *The Protectionist Bias of Duty Drawbacks: Evidence From Mercosur*, 59 J. OF INT'L ECON. 161 (2014); Jon M. Tate, *Sweeping Protectionism Under the Rug: Neoprotectionist Measures Among MERCOSUR Countries in a Time of Trade-Liberalization*, 27 GA. J. INT'L & COMP. L, 389 (1998); and Mario E. Carranza, *Can Mercosur Survive? Domestic and International Constraints on Mercosur*, 45 LAT. AM. POL. & SOC. 67 (2003).

[10] According the World Doing Business Report, PAMS were the top 4 Latin American economies for investment and have remained among the top 10 in various areas, including ease of doing business. Updated information is available at http://www.doingbusiness.org/rankings. *See also* GEORGE, THE PACIFIC PUMAS, *supra* note 7.

[11] Alvaro Pereira, *Legal Stability Contracts in Colombia: An Appropriate Incentive for Investments? Historical Causes and Impact Analysis of Law 963 to 2005*, 12 RICH. J. GLOBAL L. & BUS. 237 (2013) *See also* Marta Bengoa-Calvo, &, Blanca Sanchez-Robles, *Foreign direct investment, Economic Freedom and Growth: New Evidence from Latin America*, 19 EUROP.J.POL.ECON. 529 (2003); and Glen Biglaiser and Karl DeRouen Jr., *Economic Reforms and Inflows of Foreign Direct Investment in Latin America,* 41 LAT. AM. RES. REV. 51 (2006).

[12] For instance, all PAMS adhered to the General Agreement on Tariffs and Trade ("GATT") and are currently members of the World Trade Organization ("WTO"). Chile became a member of the GATT in

bilateral trade and investment agreements with major economies, including the United States and the European Union (*see* Table 1.1). [13]

Table 1.1. Commercial Agreements ratified by PAMS

	Commercial Agreements[14]	Countries
Chile	22	60
Colombia	15	62
Mexico	19	52
Peru	19	50

Two additional facts explain the optimism surrounding the Pacific Alliance. First, its dimensions: it is the eighth largest economy of the world,[15] with a market of 216 million people, representing 38% of Latin American and Caribbean GDP, 50% of the total trade flows in the region, and attracting 45% of the region's foreign direct investment.[16] Second, a decisive cooperation strategy—based on agreements that require no ratification for implementation—, significantly accelerated the integration process.[17] Such a strategy involved the automatic removal of over 90% of tariffs on goods and services, and a binding agreement to reach the 100% target within a few years.[18] Crucially, it provided the grounds for creating an integrated stock exchange, *Mercado Integrado Latinoamericano* (MILA), which initiated

1949, Colombia in 1981, Mexico in 1986, and Peru in 1951. Records on the WTO membership are available at https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm.

[13] *See also* Roberto Carlos Abarca, *Investment Protection and the Safeguard of the Essential Interests of the State: Drawing Lessons from the Pacific Alliance's Investment Treaty Framework*. (SECO / WTI Academic Cooperation Project Working Paper Series No. 3, 2015) (highlighting that "[t]he Additional Protocol to the Framework Agreement of the Pacific Alliance [signed in February 10, 2014] sets forth an additional layer for the promotion and protection of foreign investment to the pre-existing International Investment Agreements between the Pacific Alliance Member States")

[14] Commercial agreements include Free Trade Agreements, economic association agreements, partial-scope agreements and complementation agreements. PACIFIC ALLIANCE, *ABC Pacific Alliance* (Aug. 31, 2015) https://www.cancilleria.gov.co/sites/default/files/aliazadelpacifico/abc_alianza_del_padifico_diciembre_ingles.pdf (last visited July 2, 2020)

[15] MARCZAK & GEORGE, PACIFIC ALLIANCE 2.0, *supra* note 5, at 10.

[16] PACIFIC ALLIANCE, *ABC Pacific Alliance, supra* note 14.

[17] Id. In less than five years, a cooperation fund was established, visa requirements were eliminated, joint embassies and promotion agencies were open in different countries, and a student and academic mobility platform started to function, granting scholarships and financial support for researchers.

[18] PACIFIC ALLIANCE, *Additional Protocol to the Framework Agreement* (Feb. 10, 2014) http://www.sice.oas.org/Trade/PAC_ALL/PROTOCOLO_COMPLETO.pdf (last visited July 2, 2020)

operations in May of 2011 and currently allows listed companies of one Member State to participate in the stock market of the others.[19]

In sharp contrast with the Alliance's accelerated path towards economic integration is its influence in the evolution of corporate law and governance in the region. PAMS have individually and uncoordinatedly amended (or attempted to reform) their corporate statutes to pursue shared objectives, such as fostering entrepreneurship or promoting sustainable corporate practices. And, while the national stock exchanges that integrate MILA have induced the harmonization of securities regulations, the legal rules that govern the creation—and guide the behavior—of *all* corporations remain outside of the Alliance's economic agenda.

The disconnection between the regulation of corporations and the Alliance's broader economic policies—though paradoxical—is not unique, but rather it is characteristic of Latin America's market economies. Until recently, the lack of consensus on the specific role of capital markets in development efforts[20] and the appropriate structure of financial systems[21] debilitated corporate law reform discussions among policymakers in the region.[22] Legal scholars, in turn, have historically refrained from analyzing the *function* and *impact* of different legal institutions. Instead, most of their efforts have been devoted to questions of interpreting and deciphering the legal nature of rules and principles (e.g., civil, commercial) for the ulterior purpose of ensuring the system's coherence and uniformity in judicial decisions—what one may call *legality*.[23] Consequently,

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[19] MILA began with the integration of the stock exchanges of Santiago, Bogotá and Lima, and welcomed Mexico's in 2014. For a critical overview, see Manuel Monteagudo, *The Pacific Alliance in Search for a Financial Integration So Close and Yet So Far*, 13 GLOBAL TRADE & CUST. J. 453 (2018)

[20] For a review of the literatura, *see* Ross Levine, *Finance and Growth: Theory and Evidence*, in HANDBOOK OF ECONOMIC GROWTH, 865-934 (Philippe Aghion & Steven N. Durlauf eds. 2005)

[21] Two complementary accounts are Thorsten Beck & Ross Levine, *Stock Markets, Banks, and Growth: Panel Evidence*, 28 J. of Banking & Fin. 423 (2004), and Bernard Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets*, 47 J. OF FIN. ECON. 243 (1998).

[22] José Miguel Mendoza, *The Political Economy of Capital Markets in Latin America* (2014), http://dx.doi.org/10.2139/ssrn.2394781 (last visited Nov. 15, 2019)

[23] To be sure, emphasis on the legal nature institutions is derived from Latin American jurisdictions' bifurcation of private law into civil and commercial. Such a distinction increases the difficulty of identifying the applicable law to transactions involving business entities. *See* Francisco Reyes, *Corporate Governance in Latin America: A Functional Analysis*, 39 U MIAMI INTER-AM L REV., 207 (2008)

corporate statutes did not undergo any significant modifications until the beginning of the new millennium.

In 2003, the OECD White Paper on Corporate Governance in Latin America spawned awareness on the need to strengthen investor protection as means to improve the quality of capital markets, compelling governments to adjust securities regulations, and establish corporate governance codes.[24] The publication of the first World Bank Doing Business Report in the same year had an even more substantial impact. For the first time, discussions on the relationship between business registration requirements and development determinants (e.g., informality, entrepreneurship, employment) transcended academic debates among economists to actions by policymakers, politicians, and voters. The notion that certain countries were more "business-friendly" was now backed by data. Still, both projects established a benchmark, against which countries individually compared their regulation without measuring its impact in their business communities or citizens' lives.

Ultimately, while contributing to reveal the crucial role that corporate law and governance have in the economy, neither the White Paper nor the Doing Business promoted corporate behavior's adherence to specific development strategies or priorities. Most of the legal reforms they inspired have been individual attempts to get closer to the benchmarks or improve the country's position in various indexes, rather than fact-based policies aligning firms towards specific targets.

After almost ten years of economic integration, the pervasive pattern of independent evolution of corporate law and governance among the PAMS is disappointing but offers a unique opportunity to evaluate competing accounts on the extent to which legal institutions that determine corporate behavior can meaningfully contribute to economic growth and development. The essays that comprise this dissertation seize this opportunity, employing different methods to critically address three development objectives that have been ignored by Latin American corporate legal scholarship: sustainability, entrepreneurship, and private firms' access to external finance.

Chapter Two presents a functional comparative analysis of fiduciary duties and executive compensation, scrutinizing their ability to foster sustainability—a new

[24] For an overview of the policies, *see* OECD, STRENGTHENING CORPORATE GOVERNANCE CODES IN LATIN AMERICA: THE 2016 MEETING OF THE LATIN AMERICAN CORPORATE GOVERNANCE ROUNDTABLE (2016).

development goal, broadly understood to encompass environmental, social, and governance objectives. Chapter Three engages with the use of corporate law to foster entrepreneurial activity, offering a critical review of the damaging influence of the Doing Business project, and econometrics evidence on the impact of two legal incentives introduced by Chile and Colombia. Chapter Four introduces an index measuring the evolution of rules that determine how ownership and control is distributed in PAMS' private corporations between 1980 and 2020.

Conjunctively, the three essays demonstrate that corporate law reform—beyond business registration requirements and investor protection—can induce meaningful changes to corporate behavior with an impact on economic development determinants. The essays also find that the Pacific Alliance has not done enough to promote these objectives. In part, due to the pressures generated by the OECD White Paper and the Doing Business project, but also because of the disengagement of Latin American legal scholars. This compilation, therefore, reveals against these two forces, hoping to contribute to the reconciliation of corporate legal scholarship and economic policy. After all, they need each other to thrive.

Chapter Two

The Pacific Alliance: An Opportunity for a Sustainable System of Corporate Law and Governance in Latin America

Acknowledgement: This chapter was first published in THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY 131-145 (Beate Sjåfjell and Christopher M. Bruner eds. 2019).

1. Introduction

This chapter analyses the Pacific Alliance, an economic bloc formed by Chile, Colombia, Mexico, and Peru in 2011, and MILA (*Mercado Integrado Latinoamericano*; Latin American Integrated Market), where the stock exchanges of these nations merged. Based on contemporary developments in corporate law and corporate governance, it contends that this integration has the potential to foster the transition toward a sustainable economy.

The analysis is based on three premises. First, sustainability is humanity's ultimate challenge,[1] which urges its prioritization in all policy discussions,[2] particularly those that involve corporations.[3] Second, corporate law and governance are evolving, and recent experiences provide guidance on how to identify solutions to pressing issues. Third, the Pacific Alliance and MILA offer an unprecedented opportunity to review corporate law and corporate governance in key Latin American economies.

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[1] So much so that a new scientific field has emerged, "sustainability science." *See* Robert W. Kates, et. al., *Sustainability Science,* 292 SCIENCE 641 (2001) *See also* Jill Carle, CLIMATE CHANGE SEEN AS TOP GLOBAL THREAT (Pew Research Center 2015) (finding that climate change is perceived as a top threat in most nations of the world).

[2] Previous and current strategies are unsatisfactory. See: Glen P. Peters, et.al., *Key indicators to Track Current Progress and Future Ambition of the Paris Agreement,* 7 NATURE CLIMATE CHANGE 118 (2017), and Amartya Sen, *The Ends and Means of Sustainability* 14 J. OF HUMAN DEV. & CAPABILITIES 6 (2013).

[3] Corporations are especially important because they are among the top polluters. Some corporations even have a higher influence on climate change than entire nations. *See* Paul Griffin, THE CARBON MAJORS DATABASE: CDP CARBON MAJORS REPORT 2017 (CDP 2017).

The chapter explores two core aspects of corporate law and corporate governance: fiduciary duties and executive compensation. Section 2 introduces the Pacific Alliance and MILA, as well as their potential and limitations to promote change. Section 3 addresses fiduciary duties and legal reform. After discussing the difficulties of changing the interpretation of the duties, it proposes that a recent legal reform in Colombia may create a healthy regulatory competition in corporate law. Section 4 surveys executive compensation in the region, contrasting private ordering solutions with a regulatory alternative and theorizing on how either of those initiatives could promote sustainable corporate practices. The chapter concludes in Section 5 with reflections on lessons that may be drawn from the analysis.

2. The Pacific Alliance and MILA: a New Opportunity for Latin America

Multilateral agreements are a powerful tool for the development of different areas of law around the globe, including sustainability.[4] However, they rarely facilitate reforms in corporate law and governance. In Latin America, where economic and political integration is an entrenched historical aspiration, the regulation of business entities and particularly their decision-making processes has been traditionally left out of multilateral negotiations. As a result, virtually no binding treaty in the region includes enforceable corporate law or governance provisions. At least, until the creation of the Pacific Alliance and MILA.

In April 2011, the heads of state of Chile, Colombia, Mexico, and Peru signed in Lima a declaration of their intention to create the Pacific Alliance. In May of that year, the stock exchanges of three of the four nations announced their integration under MILA, which welcomed Mexico three years later. With the ratification of the Framework Agreement by all four signatories, the Alliance became a fully binding legal commitment on July 20, 2015.

The Pacific Alliance is the world's eighth largest economy,[5] with a market of 216 million people, representing 37 percent of Latin American and Caribbean GDP, half of the total trade flows in the region, and 45 percent of foreign direct

[4] J.B. Ruhl, *Climate Change Adaptation and the Structural Transformation of Environmental Law*, 40 ENVTL. L. 363 (2010).
[5] JASON MARCZAK & SAMUEL GEORGE, PACIFIC ALLIANCE 2.0, 10 (2016).

investment.[6] Due to a strategic cooperation plan that leverages agreements not subject to ratification, it has been able to quickly remove over 90 percent of tariffs on goods and services,[7] attracting 42 observer states.[8] The Alliance is among the largest mineral producers in the world, with Chile and Peru accounting for 40 percent of global production.[9]

In addition to facilitating trade and increasing the negotiation powers of its members, the Alliance has the potential to affect change in corporate law, corporate governance, and sustainability in the region for two main reasons. The first is that, like most Latin American countries, the four economies that constitute the Alliance have relatively small and illiquid capital markets.[10] Though this phenomenon slowed growth, it also diminished the influence and negative impact of short-termism and other detrimental social norms derived from the shareholder primacy model.[11] Hence, it offers an opportunity to collectively revise and redirect corporate law and governance.

The second potential for change arises from the integration of the stock exchanges. MILA started operations before the Alliance was legally consolidated as a bloc, signaling a reliable and consistent commitment for the coordinated development of capital markets. Governments characterized MILA as a "work-in-progress model in which the [unified] exchange will be implemented in

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[6] PACIFIC ALLIANCE, *What is the Pacific Alliance?,* https://alianzapacifico.net/en/que-es-la-alianza/#strategic-value (last visited Jun. 15, 2019).

[7] MARCZAK & GEORGE, PACIFIC ALLIANCE 2.0, *supra* note 5, at 4; and Jaime García, *Alianza del Pacífico, ¿Hacia dónde vamos?*, 31 AGENDA INTERNACIONAL 43 (2013).

[8] Observer states can participate in meetings, with the right to speak, and may apply for Membership. An updated list of observer states is available at: https://alianzapacifico.net/en/countries/ (last visited 15 Jun. 2019).

[9] RTTNEWS, *Pacific Alliance: Bloc Among Biggest Minerals Producer In The World – Minister*, BUSINESS INSIDER (Sept. 24, 2017), http://markets.businessinsider.com/news/interestrates/Pacific-Alliance-Bloc-Among-Biggest-Minerals-Producer-In-The-World-Minister-1002498617 (last visited Jun. 15, 2019). For specific data, *see* Grecia R. Matos, *Historical Global Statistics for Mineral and Material Commodities* (896 U.S. Geological Survey Data Series, 2015) http://dx.doi.org/10.3133/ds896 (last visited Jun. 15, 2019).

[10] Sudarat Ananchotikul & Barry Eichengreen, *Corporate Governance Reform in Emerging Markets: How Much, Why, and With What Effects?* 23 J. JAPANESE & INT'L ECON. 149 (2009). *See also* Augusto de la Torre, Juan Carlos Gozzi & Sergio L. Schmukler, *Capital Market Development: Whither Latin America?*, in FINANCIAL MARKETS VOLATILITY AND PERFORMANCE IN EMERGING MARKETS, 121-153 (Sebastian Edwards and Márcio Garcia eds. 2008).

[11] The influence of developed financial markets and their practices in Latin America is rather modest. This is illustrated by the 2008 financial crisis' main impact being on trade and foreign investments, rather than on the performance of stock exchanges. See: César Ferrari, *Tiempos de Incertidumbre. Causas y Consecuencias de la Crisis Mundial*, 10 REVISTA DE ECONOMÍA INSTITUCIONAL 55 (2008).

stages in order to avoid alienating various stakeholders."[12] Though they have acted accordingly, there is also evidence of concrete steps toward enhancing regulatory harmonization, particularly in accounting, tax, and securities.[13]

Despite the increasing potential for change in corporate practices, discussions on corporate law and governance have not included sustainability or any other social goals, which have been addressed separately by specific groups within the Alliance.[14] This chapter considers alternatives that could leverage the potential for regional integration to promote sustainable corporate practices, notably through fiduciary duties and executive compensation.

3. Fiduciary Duties and Legal Reform

Fiduciary duties are the backbone of corporate law and governance. They impose high standards of responsibility on those who have elevated decision-making powers, such as directors and officers.[15] Under the dominant shareholder primacy model of corporate law, only shareholders are entitled to enforce fiduciary duties, whether directly or derivatively.[16] With subtle variations that will be addressed below, legal systems in Latin America adopted that model, including specific statutory provisions for the duty to act in good faith, as well as the duties of loyalty and care.[17]

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12 PERU REPORTS, *Latin American Integrated Market (MILA)* https://perureports.com/latin-american-integrated-market-mila/ (last visited Jun. 15, 2019).

13 DIEGO AUVERT & GUILLERMO PERRY, FINANCIAL INTEGRATION IN THE PACIFIC ALLIANCE, 35-37 (2016)

14 For example, since 2012, a group has been working on a common policy for public purchases, to promote sustainable production and consumption. *See* PACIFIC ALLIANCE, *La Alianza del Pacífico Promueve Producción y Consumo Sostenible en Compras Públicas* (Feb. 13, 2018) https://alianzapacifico.net/en/la-alianza-del-pacifico-promueve-produccion-y-consumo-sostenible-en-compras-publicas-2/ (last visited Jun. 15, 2019).

15 Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J. L. & ECON. 425 (1993).

16 Generally, *see* Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?* 7 J.L. ECON. & ORG. 55 (1991). For a defense of this model, see: Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties* 21 STETSON L. REV. 23 (1991)

17 For the legal definition of the duty of loyalty in the Pacific Alliance member States, *see* article 44 of Chilean Law of Corporations, Ley No. 18.046 (1981) [hereinafter, Chilean LC]; article 23 of Colombian Ley 222 (1995); article 156 of Mexican General Law of Mercantile Companies (1934) [hereinafter, Mexican GLMC]; and article 180 of Peruvian General Company Law, Law 26887 (1997) [hereinafter, Peruvian GCL]. For the duty of care, see: articles 41 and 133 of Chilean LC; article 23 of Colombian Law 222 of 1995; article 1567 of Mexican GLMC; and article 177 of Peruvian GCL.

Given their irrevocability and the possibility of requesting damages in case of a breach, fiduciary duties are among the strongest tools to guide the behavior of corporate fiduciaries – and, in turn, corporations. However, the potential to do so in society's best interest has rarely been explored, since the duties have been deliberately limited to protect shareholders' interests,[18] notably, leaving environmental protection to other areas of law.[19] This is also the case in the Pacific Alliance member states, but recent developments suggest that variations remain possible.

The following analysis will first explain how the current regulation of fiduciary duties is insufficient to prevent unsustainable corporate practices; second, reveal the challenges of affecting change through legal reforms; and third, show that there is an emerging regulatory competition in the Pacific Alliance that arguably may be characterized as a race to the top in corporate law.

3.1. The monistic nature of fiduciary duties in the Pacific Alliance

As stated above, all member states of the Alliance have statutory provisions for the duties of loyalty, care, and good faith. Although the statutes resemble the shareholder primacy model, some provide subtle variations seemingly permitting a slightly broader approach. An example is the Peruvian General Company Law, according to which directors owe duties to the corporation, its shareholders, and third parties.[20] While the law explicitly refers to "third parties," only creditors are allowed to challenge the behavior of directors and officers when there is proven risk of default and with the exclusive purpose of preserving corporate assets,[21] a high threshold that limits the scope of the protection granted by fiduciary duties to shareholders' interests.

In Colombia, corporate law states that directors and officers should act in the "interest of the corporation, taking into account the interests of shareholders,"[22]

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[18] To a large extent, Courts have adopted this interpretation because only shareholders can claim their enforcement on behalf of the corporation. For an analysis of the rationale behind derivative actions, see: Dana Brakman, *Corporate Law, Corporate Governance and Sustainability in the United States*, in CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY 131-145 (Beate Sjåfjell and Christopher M. Bruner eds., 2019).

[19] Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989).

[20] Article 177 of Peruvian GCL.

[21] *See* Id., article 181.

[22] Article 23 of Colombian Law 222 (1995).

which suggests that the former could include other interests separate from those of shareholders. Absent a legal restriction equivalent to that of Peruvian law, it would appear plausible for judges to adopt a broader interpretation. However, the regulator has repeatedly specified that the promotion of shareholder value precedes other interests and should always prevail.[23] Influential scholarship in the country further supports that line of interpretation.[24]

Similarly, Courts in Chile have found that fiduciary duties are not only grounded in specific corporate law provisions, but also in the agency relationship between fiduciaries and the corporation.[25] The fact that only shareholders have standing to request them in both countries, as well as in Mexico and Peru,[26] in practice constrains the interest of the corporation to that of shareholders.

Expanding the scope of fiduciary duties would require a pluralistic interpretation of the interest of the corporation, granting legal standing to stakeholders and encouraging boards to give sustainability a higher weight in the decision-making process. However, such an interpretation faces two main barriers: weak enforcement and the strengthening of the shareholder primacy model, through the introduction of codes of best practices in corporate governance. Latin America's underperforming judiciaries, bluntly put, explain the former. It takes more time to complete a procedure and the costs as a percentage of a claim are higher.[27] In the area of corporate law, this concern is particularly worrisome, to the point that the OECD acknowledged it as one of the core issues preventing its development.[28] Consequently, litigation is infrequent, depriving fiduciary duties of their ability to protect even minority shareholders.

While governments increased their efforts to improve enforcement, there is no uniform solution for corporate law disputes among member states of the Pacific

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[23] *See* SUPERINTENDENCIA DE SOCIEDADES, Oficio 220-045619 (2012), and Oficio 220-132260 (2016).
[24] NESTOR HUMBERTO MARTÍNEZ, CÁTEDRA DE DERECHO CONTRACTUAL SOCIETARIO: REGULACIÓN COMERCIAL Y BURSÁTIL DE LOS ACTOS Y CONTRATOS SOCIETARIOS, 155 (2010).
[25] *See* Civil 1916/2006 Tercera Sala de Corte de Apelaciones, Santiago.
[26] Article 161 of Mexican GLMC provides that only shareholders can enforce fiduciary duties. In Peru, the equivalent norm is in article 181 of Peruvian GCL.
[27] According to the 2016 Doing Business Report, resolving "a standardized commercial dispute between two domestic businesses through local first-instance courts' took an average of 1,288 days" in Colombia. *See* WORLD BANK, DOING BUSINESS 2016: MEASURING REGULATORY QUALITY AND EFFICIENCY, 195 (2016).
[28] *See* OECD, SYNTHESIS NOTE: THE LATIN AMERICAN CORPORATE GOVERNANCE ROUNDTABLE, 26-28 (2000).

Alliance. Chile opted for mandatory arbitration;[29] Colombia opted for a regulator with jurisdictional powers;[30] and Mexico and Peru relied on civil judges**,** with voluntary arbitration**.**[31] In this context of weak enforcement of fiduciary duties (even in a restricted approach), it appears unreasonable to expect changes in judicial interpretation.

The introduction of best practices codes has reinforced the shareholder primacy model, limiting the potential for alternative interpretations. The core instrument prompting this trend is the OECD White Paper on Corporate Governance in Latin America, which emphasized the need to strengthen investor protection to mitigate the negative effects of a generalized pattern of stock ownership concentration.[32] Although there are variations, each member state substantially adopted the recommendations.[33]

In this environment, legal reform seems to be a more realistic avenue towards change in fiduciary duties than expecting interpretative variations in case law or influential legal scholarship. The next subsection analyses the latest reform among the Alliance member states and the implications of specific legislative choices, which go beyond fiduciary duties.

3.2. Companies of Collective Benefit and Interest

Among the possible sustainability-oriented reforms to corporate law, the introduction of a variant of the benefit corporation has gained some traction in Latin America. The interest arose from the experience of B Lab in the United States, where a private certification system paved the way for the creation of new legal entities.[34]

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[29] Artice 4.10 of Chilean LC.

[30] Article 116 of the Colombian Constitution, article 252 of Law 1450 (2011), and article 24.5 of Law 1564 (2012).

[31] For a critical overview of the infrequent use of arbitration for corporate disputes in Peru, *see* José Ulises Montoya Alberti, *Corporate Arbitration,* 18 *Docentia et Investigatio* 35 (2016). For a comparative approach to the Mexican experience, see: Felipe Miguel Carrasco, *Arbitraje Societario,* 39 JURÍDICA – ANUARIO 347 (2009).

[32] OECD, WHITE PAPER ON CORPORATE GOVERNANCE IN LATIN AMERICA (2003).

[33] OECD, STRENGTHENING CORPORATE GOVERNANCE CODES IN LATIN AMERICA: THE 2016 MEETING OF THE LATIN AMERICAN CORPORATE GOVERNANCE ROUNDTABLE (2016).

[34] For a historical recollection of B Lab's work, see: Brakman, *Corporate Law, Corporate Governance and Sustainability in the United States*, *supra* note 18;
Murray, J. Haskell, *Choose Your Own Master: Social Enterprise, Certifications and Benefit Corporation Statutes,* 2 AM. U. BUS. L. REV. 1 (2012); and Frederick Alexander, BENEFIT CORPORATION LAW AND GOVERNANCE, 2 (2018). For a critical review, see: Carol Liao, *Social Enterprise Law: Friend or Foe to*

Inspired and supported by B Lab, entrepreneurs from Argentina, Chile, and Colombia created Sistema B in 2012.[35] This non-profit replicates the experience of B Lab, certifying corporations that commit to adjust their businesses to specific social, environmental, and governance standards. By 2017, Sistema B had certified over 400 corporations in Latin America, established official branches or working groups in most countries of the region, and introduced legislative projects in the three pioneering jurisdictions.[36]

In June 2018, the Colombian government sanctioned Law 1901 (BIC Law) introducing the *Companies of Collective Benefit and Interest (BIC)*.[37] Authored by the elected president and supported by Sistema B, the law may prompt regulatory competition between the Pacific Alliance member states.[38] The enactment of the law could also influence legislative agendas in greater Latin America, where the approval of similar initiatives has been delayed.[39]

Colombia opted for a legal certification system, instead of a new entity form.[40] In that sense, all business entities, including corporations, can adopt the BIC legal denomination,[41] which resembles the approach of Denmark and some eastern European countries. It is striking that its proponents did not review these processes. Instead, the proposal relied on Sistema B's account of the experiences of jurisdictions that created new legal entities, such as the United States or the United Kingdom. In doing so, the legislator opened a gap between what is expected from BICs and the real changes it introduces. Legal certification systems have produced modest results without complementary policies.[42] In Denmark, for instance, the scheme is "only known among people within the social enterprise field," albeit being available for over four years.[43] In contrast, the increasing usage of the community

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Corporate Sustainability?', in CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY, 655-668 (Beate Sjåfjell and Christopher M. Bruner eds., 2019).

35 SISTEMA B, *Quiénes Somos*, https://sistemab.org/quienes-somos-4/(last visited Jun. 15, 2019).

36 SISTEMA B, *Reporte de Avances* (Oct. 17, 2017), https://sistemab.org/wp-content/uploads/2017/10/Reporte-de-avances-Sistema-B-Octubre-2017.pdf (last visited 15 Jun. 2019).

37 Ley 1901 (2018), available at http://es.presidencia.gov.co/normativa

38 *See* section 3.4 below.

39 SISTEMA B, *Reporte de Avances, supra* note 36.

40 For an overview of legislative alternatives, *see* Liao, *Social Enterprise Law*, *supra* note 34.

41 Ley 1901 (2018), article 1.

42 SOCIAL ENTREPRENEURSHIP ASSOCIATION OF LATVIA, SOCIAL ENTREPRENEURSHIP CERTIFICATION AND LABELING (2018) https://xn--sociale-entreprenrer-rcc.dk/assets/files/Norden-Rapport-marts-2017-1.pdf (last visited Jun. 15, 2019).

43 Id., at 26.

interest company in the United Kingdom is linked to specific features that were excluded in Colombia, such as asset locks or dividend caps, which aim to ensure that profits are retained or used for the designated public benefit.[44]

Notwithstanding this limitation, Colombia's BIC Law introduces four main corporate law innovations. The first innovation is the expansion of the company's interest to include "those activities of collective benefit and interest that the company is intended to promote," which do not necessarily have to be profitable or even measurable under financial metrics.[45] It is a step forward, but a limited one. On one hand, the Colombian legal system is already tolerant of non-profit activities, allowing their promotion as long as they do not compromise profits.[46] That has allowed some companies to adjust their business models and get certified by Sistema B, despite not being able to include them in the company's interest. On the other hand, even though the law expressly requires the inclusion of non-profit activities in the interest, it does not establish a priority, but rather subjects its interpretation to current standards.[47] Consequently, while the BIC Law is not affecting immediate changes in the approach to the company's interest, it is promoting the emergence of new scholarship, capable of offering guidance to shareholders and boards on how to maximize this innovation. A new question, for instance, is: when would it be reasonable to prioritize the benefit interest?

The second novelty is in fiduciary duties. The law establishes that, in addition to traditional duties, directors of BICs must "consider the collective benefit and interest" defined in the corporate charter.[48] Relying on litigation to ensure that BICs protect stakeholders' interests presupposes that they already protect the interests of shareholders, which is not the case, as explained above. Increasing the complexity of the system could further extend the length of the procedures and deter litigation. Moreover, the fact that only shareholders have standing to enforce them weakens fiduciary duties' capacity to protect stakeholders' interests. Still, it authorizes boards to go beyond the bottom line of profit, and to discuss the company's broader inclusive strategy in depth. As with the company's interest, then, it appears that the law opens a narrow – yet valuable – window for new scholarship to discuss the

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44 Liao, *Social Enterprise Law*, *supra* note 34.
45 Ley 1901 (2018), article 2.
46 *See* article 100 of the Commercial Code, as reformed by article 1 of Ley 222 (1995), and SUPERINTENDENCIA DE SOCIEDADES, Oficio 220-132260 (2016).
47 *See* Ley 1901 (2018), articles 2 and 9.
48 Ley 1901 (2018), article 4.

scope of these new features and provide guidance to boards. An emerging concern is the optimal time boards should spend discussing financial and non-financial aspects of the business.[49]

The law also introduces new reporting and disclosure obligations. In line with B Lab's model law, a BIC must produce an annual report detailing the activities conducted to achieve its benefit interest. This seemingly clear mandate has two problematic implications. First, the law stipulates that the report must be consistent with a standard previously elaborated by a third party and approved by the Superintendence of Companies, after evaluating the reputation of said standard, as well as its independence, comprehensiveness, reliability, and transparency.[50] The agency is the chief national authority in all company law matters, with both jurisdictional and administrative powers, and enjoys high credibility among both businesses[51] and independent observers.[52] However, its lack of experience in social and environmental concerns diminishes its ability to adequately fulfill this mandate, as was noted by its head officer.[53] Although the Superintendence's comparatively superior record in assuming new functions might justify this decision in Colombia,[54] it is not necessarily an ideal precedent for the region.

The second problem is the differentiated enforceability of the obligations to report and disclose. Regarding the former, the law expressly states that the company's legal representative is responsible for preparing and incorporating the report in the annual shareholder report,[55] making it clear that this is a duty owed to shareholders, who can judicially enforce it. In contrast, the law does not specify the consequences of not complying with the obligation to disclose. Preliminary studies

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[49] Evaluating non-financial performance is a complex enterprise. *See* Aaron Chatterji and David Levine, *Breaking Down the Wall of Codes: Evaluating Non-financial Performance Measurement*, 48 CAL. MGMT. REV. 29 (2006).

[50] Ley 1901 (2018), article 5.

[51] According to a national survey advanced by the Superintendence of Companies among supervised business entities, it enjoys 84% of favorable perception for corporate social sustainability. SUPERINTENDENCIA DE SOCIEDADES, *Imagen Positiva de la SuperSociedades Alcanza el 84% Según Encuesta de Responsabilidad Social Empresarial*, SUPERSOCIEDADES NOTICIAS (May 4, 2014), www.supersociedades.gov.co/Noticias/Paginas/2014/imagen-positiva-de-la-superSociedades-encuesta-de-responsabilidad-social-empresarial.aspx (last visited Jun. 15, 2019).

[52] TRANSPARENCIA COLOMBIA & EUROPEAN UNION, INDEX OF TRANSPARENCY OF GOVERNMENTAL AGENCIES 2015-2016 (2016) (rating the Superintendence of Companies as the first of sixty six agencies)

[53] SUPERINTENDENCIA DE SOCIEDADES, *Comentarios Proyecto de Ley 135 de 2016 – Senado, Oficio 2016-01-560266*, SUPERSOCIEDADES (Nov. 11, 2016), www.camara.gov.co/camara/visor?doc=/sites/default/files/2017-10/7.COMENTARIOS%20SUPERSOCIEDADES.pdf (last visited Jun. 15, 2019).

[54] *See* TRANSPARENCIA COLOMBIA & EUROPEAN UNION, INDEX, *supra* note 52.

[55] Ley 1901 (2018), article 5.

in the United States found that less than ten percent of companies with equivalent obligations complied with them.[56] B Lab's model law required companies to file reports with the Secretary of State.[57] This could have been a valuable alternative since in Colombia, filing documents with the commercial registry is a specific duty of managers, breach of which leads to administrative sanctions and can potentially be enforced judicially.[58]

The final innovation of the law is the procedure and circumstances leading to the revocation of the BIC legal certification. The law assigns the Superintendence of Companies exclusive authority to declare it, upon request of any interested party and with proof of "reiterated and gross breach of independent standards."[59] Since the sanction does not entail the liability of directors and officers, it seems inadequate to align their behavior to the company's benefit interest.[60] Currently, their breach of legal and contractual obligations can lead to severe individual administrative sanctions.[61] In contrast, the BIC Law does not provide a sanction for executives that grossly and repeatedly breach the company's selected standard.

Hence, it could even be an opportunity for ill-intentioned investors, who could take advantage of a company's struggle to request the exclusion of the BIC legal certification and the adoption of an exclusively for-profit business model. The experience of Etsy in the United States is a reminder of this threat.[62]

The analysis above reveals that adjustments in corporate law towards sustainable development are difficult but possible, even beyond fiduciary duties. The creation of a common market without a common strategy to introduce changes in corporate law provides the basic conditions for a regulatory competition aimed at attracting sustainable business actors. Whether such a competition could, in fact, improve the quality of the law is the focus of the next subsection.

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56 Haskell Murray, *An Early Report on Benefit Reports,* 118 W. VA. L. REV. 25, 25 (2015).
57 MBCL § 402.
58 Colombian Code of Commerce, article 200.
59 Ley 1901 (2018), article 7.
60 Instead, the sanction seems more effective to help consumers identify which companies are committed to the purpose of the BIC Law and which are not.
61 Law 222 (1995), article 87. *See also* SUPERINTENDENCIA DE SOCIEDADES, OFICIO 220-037866 (2008)
62 Etsy, an online platform for the commercialization of handmade products, was the first B Lab certified corporation to go public in the United States. Following a decline in revenues, a group of investors forced changes in management, leading to cuts in the workforce and non-renewal of its B Lab certification. *See* David Gelles, *Inside the Revolution at Etsy*, N.Y. TIMES, BU1 (Nov. 25, 2017) https://www.nytimes.com/2017/11/25/business/etsy-josh-silverman.html

3.3. Regulatory competition: an incentive to rethink fiduciary duties

Generally, regulatory competition refers to a situation in which different jurisdictions adjust their regulations to attract and retain market actors.[63] Within corporate law, there are mixed accounts on its effects and pertinence. A series of studies argue that it originates a race to the bottom, with directors deciding to move firms to jurisdictions with lower shareholder protection.[64] Other studies assert that it creates a race to the top, because investors would prefer jurisdictions with stronger shareholder protection.[65] Yet other accounts suggest that minor legal adjustments do not influence the decisions of market participants, but that it is "the whole institutional-legal system of a jurisdiction that 'competes' with other systems."[66]

Notwithstanding the lack of consensus on the effects of regulatory competition, what remains apparent is that in a common market where firms have free choice of law and freedom of movement, jurisdictions have a higher incentive to adjust corporate law.[67] By liberalizing trade, as well as the movement of people and resources, the Pacific Alliance created the basic conditions for a regulatory competition in corporate law that could be leveraged to promote sustainable corporate practices. Colombia took a first concrete action in this competition, enacting the BIC Law. It is reasonable to expect a reaction from legislators in other Pacific Alliance member states because there are similar projects already in their agendas.[68]

Due to the recent origin of this regulatory competition, there is insufficient evidence for a conclusive evaluation of its fate. However, considering its goals and scope, it would be reasonable to expect a race to the top in corporate law. Unlike the traditional corporate charter competition, characterized by an ongoing debate on the desired outcomes and aimed at attracting all types of firms,[69] this competition

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[63] Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle,* 1 J.L. ECON. & ORG. 225 (1985).
[64] William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L. J. 663 (1974).
[65] STEPHEN BAINBRIDGE, CORPORATION LAW AND ECONOMICS, 612-614 (2002); and ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION, 64-73 (2002).
[66] Claudio M. Radaelli, *The Puzzle of Regulatory Competition,* 24 J. PUB. POL'Y 19 (2004).
[67] Frank Easterbrook, *Antitrust and the Economics of Federalism,* 26 J. L. & ECON. 23 (1983).
[68] SISTEMA B, *Reporte de Avances, supra* note 36.
[69] Radaelli, *The Puzzle of Regulatory Competition*, *supra* note 36.

seeks to increase the number of sustainable corporate actors. To the extent that one agrees that it is desirable to have more sustainable businesses, it is a potential race to the top: it incentivizes legislators to improve corporate law, by offering the most attractive regulation for these businesses. Although other forces might continue exhorting influence towards shareholder primacy in the region, Colombia's BIC Law is a call for action, as it offers a concrete option in corporate law for social enterprises. If the demand for these alternatives continues growing, this emerging competition can guide the development of corporate law towards sustainability in the Pacific Alliance member states.

Corporate governance could further support changes in corporate behavior. The next section focuses on executive compensation, a key determinant of public corporations' performance and practices.

4. Executive Compensation

Executive compensation is a powerful tool to promote sustainable corporate practices. Rewarding top executives for the achievement of concrete goals could be crucial to accelerate the transition toward a new way of doing business – mainly, though not exclusively, because it is not contingent upon corporate law reform. In Latin America, it is particularly pertinent given the difficulties described above with changing the interpretation or content of corporate law. Absent a common standard for executive compensation in the region, there is ample room to promote sustainability through new incentives.

This section evaluates three approaches: first, allowing corporations to decide their compensation schemes, leaving the evolution of executive compensation to the market; second, creating a code that promotes new compensation structures, attaching a portion of them to the fulfillment of specific goals, set up on an industry basis; and third, leveraging ongoing legal convergence to develop common standards, even in the absence of a code.

4.1. Private ordering

In a one-tier board structure, where executive officers and directors work closely together and at times share both roles, one could reasonably reject a private ordering solution as ineffective. Directors' main legal duty is widely thought to be

promoting shareholder value. Hence, compensation would most likely be used to incentivize financial goals.[70]

Notwithstanding this well-documented contemporary phenomenon, there are reasons to think that private incentives for sustainability could work. Recent experiences demonstrate that businesses that decide to anticipate regulatory requirements and pioneer in the implementation of sustainable practices get competitive advantages in the market, improving their operations, supply chains, consumer engagement as well as financial performance.[71]

Across the world, directors are responding to these changes and anticipating the emergence of stricter legal sustainability standards. In Japan, a growing number of companies are establishing and disclosing novel executive compensation packages that tie payment to non-financial objectives. In some cases, meeting corporate social responsibility goals could increase compensation up to 200 percent.[72] In Germany, there is evidence that "non-financial elements (social or environmental aspects) in management board compensation positively influence [environmental, social, and governance] performance."[73] These examples illustrate the increasing interest in promoting sustainable corporate practices through private ordering. Executive compensation appears to be even more appropriate in markets with concentration of ownership and higher monitoring powers from controlling shareholders, as in Latin America, since it is less likely to create additional agency costs.[74]

Despite this evidence, executive compensation is a contentious subject in the Pacific Alliance. The lack of an official common metric creates difficulties to

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[70] In fact, the origins of contemporary issues associated to excessive risk-taking, misreporting, and short-term investments can be traced to the emergence of compensation packages. See: Natasha Burns & Simi Kedia, *The Impact of Performance-Based Compensation on Misreporting,* 79 J. FIN. ECON. 35 (2006). *See also* Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance,* 37 J. CORP. L. 265 (2011).

[71] Tensie Whelan & Carly Fink, *The Comprehensive Business Case for Sustainability*, HARV. BUS. REV. (Oct. 21, 2016). *See also* Ram Nidumolu, C.K. Prahalad & M.R. Rangaswami, *Why Sustainability Is Now the Key Driver of Innovation*, HARV. BUS. REV. (Sept. 1, 2009)

[72] Taizo Wada, *How "ESG" is the Boss? Japan Inc. to Include Social Responsibility in Bonuses,* NIKKEI ASIAN REV., (Sept. 21, 2017).

[73] Patrick Velte, *Sustainable Management Compensation and ESG Performance—The German case*, 14 PROBLEMS & PERSPECTIVES IN MGMT. 17 (2016).

[74] Guido Ferrarini & Maria Cristina Ungureanu, *Executive Remuneration*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 334-362 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018)

determine its influence on corporate objectives.[75] Additionally, each nation faces particular difficulties. In Mexico, for example, compensation incentives are mostly used to retain talent.[76] Despite their potential to reach broader strategic objectives, attention has shifted towards preventing corruption, due to a series of scandals involving top executives.[77] In Peru, where cash incentives for long-term goals are common, corporations remain reluctant to reveal individual salaries alleging that it could compromise the security of directors. [78] In Chile and Colombia, the relation between compensation and performance remains inconclusive.[79]

Given the wide range of options available for boards to structure executive compensation and growing public distrust, corporations should begin by increasing transparency – a precondition for the success of any compensation strategy.[80] Disclosure of compensation structures would send the right signals to investors and propitiate discussion. Numerous investors have already implemented principles for remuneration in other jurisdictions, "setting their own views of the role of shareholders and directors in relation to remuneration." [81]

To measure sustainability accomplishments from a private ordering perspective, it seems appropriate to start by reducing or eliminating bonuses to those who threaten the environment, whether polluting or failing to prevent pollution.[82] Once each corporation defines its long-term strategy and appropriate metrics to measure progress, bonuses for achieving them could be granted, just as it is starting to happen in Japan.[83]

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75 *See* Ivana Thornton & Martín Ibáñez-Frocham, *Remuneración de Ejecutivos: Tendencias en América Latina 2017,* HEALTH WALTH CAREER (Jun. 30, 2015).
76 PWC, EXECUTIVE SALARY SURVEY 2016 PWC MÉXICO, 1 (2016).
77 María Alejandra Rodríguez, *Corrupción en Empresas Inicia con Intermediarios*, EL ECONOMISTA (Feb 21, 2017).
78 Rodrigo Salazar, *¿Se debe transparentar la remuneración de los CEO peruanos?*, SEMANA ECONÓMICA (Aug. 4, 2016).
79 Thornton & Ibáñez-Frocham, *Remuneración de Ejecutivos, supra* note 75.
80 Lucian Bebchuk & Jesse M. Fried, *Pay Without Performance: Overview of the Issues,* 17 J. APPLIED CORP. FIN. 8 (2005)
81 Ferrarini & Ungureanu, *Executive Remuneration*, *supra* note 74.
82 *See* Seymour Burchman & Barry Sullivan, *It's Time to Tie Executive Compensation to Sustainability,* HARV. BUS. REV., (Aug. 17, 2017).
83 Wada, *How "ESG" is the boss?, supra* note 72.

4.2. Executive Compensation Code

An alternative to private ordering is to legally require companies to tie compensation to the accomplishment of sustainability goals. This would be a more challenging approach and it is thus reasonable to expect some resistance to this measure – mainly, because it has not been tested in the region, but also because executive compensation is, despite scandals and public debates, the result of private agreements. Still, the potential benefits justify considering it seriously. A historical account of the regulation of corporate boards provides useful guidance to theorize about an Executive Compensation Code.

Traditionally, there was little that corporate law was seen to be able to do to guide the behavior of boards, beyond fiduciary duties. That might be the reason why some contended that corporate law was unable to bring into equilibrium the conflicting objectives of different actors.[84] Such incapacity became apparent in the early 1990s, when London's reputation as a financial center began to be questioned. In response, a private initiative promoted by the London Stock Exchange, the Financial Reporting Council, and accounting firms, led to the establishment of a Committee, chaired by Sir Adrian Cadbury.[85] The Committee delivered a two page Code of Best Practice, frequently referred to as the *Cadbury Code*. Although subjected to multiple amendments and replaced in 2014, the Cadbury Code is still considered "one of the most significant events in modern corporate governance."[86]

The Cadbury Code teaches two important lessons that can inform the creation of a legal standard for executive compensation. The first is that it emerged from discussions among different actors with the common interest of improving boards' performance. That is to say, it started with an agreement among those who would have to follow these new guidelines (though it is worth noting that the pressure to reform originated in a scandal that affected the market's credibility).[87]

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[84] Ronald Gilson, *From Corporate Law to Corporate Governance*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 3-27 (Jeffrey N. Gordon & Wolf-Georg Ringe, eds., 2018)

[85] Brian R. Cheffins, *The History of Corporate Governance*, in OXFORD HANDBOOK OF CORPORATE GOVERNANCE, 46-64 (Douglas Michael Wright, Donald S. Siegel, Kevin Keasey & Igor Filatotchev, eds. 2013).

[86] Cally Jordan, *Cadbury Twenty Years On* (Center for Transnational Legal Studies Research Paper No. 12-136, 2012)

[87] Paul Davies, *Board Structure in the UK and Germany: Convergence or Continuing Divergence?,* 2 INT. & COMP. CORP. L. J. 435 (2000)

The second lesson is the principle (or regulatory strategy) of comply-or-explain.[88] The Code introduced higher standards for boards but made compliance voluntary.[89] This strategy permitted the gradual implementation of best practices in boards and became an essential aspect of corporate governance.[90]

In Latin America, the most influential instrument guiding board behavior is the OECD White Paper.[91] It followed the aforementioned lessons from the Cadbury Code, by gathering market participants and jointly identifying the region's main challenges.[92] The White Paper concluded with an agreement on the need to adopt codes of best practices implementing the comply-or-explain regulatory strategy.[93] The adoption of those recommendations suggests that it was also beneficial for the region,[94] even if it tended to strengthen the shareholder primacy model.

These are valuable experiences to consider in designing a regulatory approach of executive compensation to guide corporate behavior towards sustainable practices. The first step is, then, to reach an agreement among market participants. While concerns on corruption and lack of transparency are already permeating public opinion, a scandal should not be a precondition to gather market participants. The opportunity to prevent scandals and promote the inclusion of sustainability in corporate governance should be sufficient for MILA and the Pacific Alliance to encourage discussions on the matter. The recent creation of the Dow Jones

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[88] Ruth V. Aguilera, & Alvaro Cuervo-Cazurra, *Codes of Good Governance,* 17 CORP. GOV. INT. REV. 376 (2009)

[89] Section 3.7 of the Code contains a Statement of Compliance, crystalizing the principle in the following terms: "We recommend that listed companies reporting in respect of years ending after 30 June 1993 should state in the report and accounts whether they comply with the Code and identify and give reasons for any areas of non-compliance." COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE, REPORT ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE, 17 (1992).

[90] "The comply or explain approach has since [the Cadbury Code] spread to dozens of countries… Even in the United States, where legislation (most recently exemplified by the Sarbanes-Oxley Act) is preferred, [it] has crept in." Paul Coombes & Simon Chiu-Yin Wong, *Why Codes of Governance Work,* 2 *The McKinsey Quarterly* 51 (2004). *See also* Philip Stiles and Bernard Taylor, *Benchmarking Corporate Governance: The impact of the Cadbury Code,* 26 LONG RANGE PLANNING 61 (1993).

[91] Aguilera & Cuervo-Cazurra, *Codes of Good Governance, supra* note 88.

[92] Detailed information about the agenda and conclusions of the first meeting of the Latin American Corporate Governance Roundtable in 2000 is available at www.oecd.org/daf/ca/corporategovernanceprinciples/firstmeetingofthelatinamericancorporategovernanceroundtable.htm (last visited Jun. 8, 2019)

[93] For example, section 86 provided: "Regulators and exchanges should require such disclosure, and where recognized standards exist, provide that the company describe the justification for any divergence from the practices recommended in such standards." OECD, WHITE PAPER ON CORPORATE GOVERNANCE IN LATIN AMERICA, *supra* note 32, at 24.

[94] OECD, STRENGTHENING CORPORATE GOVERNANCE CODES IN LATIN AMERICA, *supra* note 33.

Sustainability MILA Pacific Alliance Index suggests that there is interest among investors.[95]

Since the objective is to include incentives for sustainability in compensation packages, a starting point is to establish concrete objectives. Acknowledging that environmental and social impact varies among industries, it appears reasonable to identify goals by sector. Giving voice to industry leaders would be valuable to discuss the goals' feasibility and strengthen their commitment from the beginning. In turn, a code could compile recommended structures by industry, tying compensation to sustainability goals. To address the justified concerns about the security of directors in some countries, the recommendations could be implemented in bloc, by industry, and only revealing the proportions of the compensation that are related to relevant goals, without disclosing specific salary numbers.

An Executive Compensation Code should adopt the comply-or-explain strategy. Even if no corporation complies at first, the debate will arguably be open, which would be an improvement. This is one of the main lessons from the regulation of corporate boards. In the words of Sir Andrew Cadbury, "the most obvious consequence of the publication of the 1992 Code of Best Practice was that it put corporate governance on the board agenda. Boards were asked to state in their reports and accounts how far they complied with the Code and to identify and give reasons for areas of non-compliance."[96]

A Code of this nature could not only promote sustainable business practices, but also help improving corporate governance generally, and transparency in executive compensation specifically. By subjecting executives, as a bloc, to industry-specific compensation schemes, hopefully the emphasis would shift from the anger-generating exercise of comparing executive salaries with those of average workers, to a constructive and open debate of how corporations are inducing their leaders to take further steps to promote sustainability.

MILA has propitiated a coordinated approach to corporate governance that could be leveraged to facilitate improvements in executive compensation. The next subsection offers further evidence of an ongoing process of legal convergence that

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[95] S&P DOW JONES INDICES, *Robecosam, Ifc And Mila, Launch Dow Jones Sustainability Mila Pacific Alliance Index*, S&P (Oct. 18, 2017)

[96] ADRIAN CADBURY, CORPORATE GOVERNANCE AND CHAIRMANSHIP: A PERSONAL VIEW, 20 (2002).

could be useful to accelerate the path towards sustainable corporate practices, even without a code.

4.3. Legal convergence

In a broad sense, legal convergence may arise from states' efforts to reduce divergences between their legal systems.[97] Since convergence is not a value in itself, efforts toward harmonization demand thorough consideration. Legal differences can be the result of particular needs and often express local preferences, facilitating the application of the law.[98] They also promote experimentation with alternative solutions to shared issues, which can contribute to identifying the most appropriate one over time.[99]

In an integrated market, however, divergences could create undesirable effects. Market participants are likely to incur substantial costs to meet the requirements of each jurisdiction (transaction costs) and one jurisdiction can end up bearing the costs of the legal choices made by others (externalities).[100] Convergence is, then, a desirable solution to these potential adverse effects of integration.

In the Pacific Alliance, there are no current attempts to achieve convergence in corporate law but there is a perceivable interest in harmonizing corporate governance. As discussed above, the OECD White Paper established a common guideline for Latin American countries, which was gradually followed by most countries in the region. With the creation of MILA, member states took further steps toward regulatory cooperation,[101] with regulators even proposing to gradually transfer enforcement authority to supranational bodies.[102] This ongoing legal convergence in corporate governance could be leveraged to promote sustainable corporate practices through executive compensation, even in the absence of a code.

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[97] Alasdair Young, *Liberalizing Trade, Not Exporting Rules: The Limits to Regulatory Co-Ordination in the EU's "New Generation" Preferential Trade Agreements,* 22 J. EUR. PUB. POL'Y 1 (2015).
[98] Ugo Mattei & Alberto Monti, *Comparative Law and Economics: Borrowing and Resistance,* 1 GLOB. JURIST FRONTIERS 2 (2001).
[99] Id.
[100] Filomena Chirico & Pierre Larouche, *Convergence and Divergence, in Law and Economics and Comparative Law'*, in NATIONAL LEGAL SYSTEMS AND GLOBALIZATION, 9-33 (Pierre Larouche & Peter Cserne eds. 2013).
[101] Manuel Monteagudo, *The Pacific Alliance in Search for a Financial Integration: So Close and Yet so Far* (SECO/WTI Academic Cooperation Project Working Paper Series No. 17, 2017).
[102] José Miguel Mendoza, *The Political Economy of Capital Markets in Latin America* (2014), http://dx.doi.org/10.2139/ssrn.2394781 (last visited Jun. 15, 2019)

A common standard for executive compensation would directly increase transparency, which is linked to a reduction in transaction costs arising from information asymmetries,[103] common in expanding markets. In addition to improving investors' and regulators' ability to evaluate companies participating in the integrated stock exchange, the inclusion of a sustainability component in compensation would increase its weight in managerial and investment decisions. Convergence could also reduce the risk of externalities. In markets for managerial labor, a frequent externality is the increase of performance-based executive compensation at the expense of the quality of corporate governance, which "produces weaker overall governance in the economy."[104] The integration process increased the size of the market as well as the risks of experiencing this and other externalities. Legal convergence in executive compensation could alleviate these risks, by requiring higher disclosure requirements, as well as sustainability incentives and comparable improvements in corporate governance.

5. Conclusion

Although globalization spread hazardous social norms, the early stage of capital market development in Latin America has prevented their full absorption. The current context offers an exceptional opportunity to promote a sustainability-oriented evolution of corporate law and corporate governance in key jurisdictions: Chile, Colombia, Mexico, and Peru. The Pacific Alliance and MILA provide a platform for an open discussion on the necessary steps to take, which should include a reformulation of fiduciary duties and a clear agenda for executive compensation.

This chapter explained how current corporate law is insufficient to confront humanity's ultimate challenge, achieving sustainability. The dominant interpretation of corporate statutes among judges and scholars reproduces the shareholder primacy model. The inflexibility of these positions as well as external

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[103] Isabel Y. Wang, Xue Wang & Daniel Wangerin, *Consequences of Increased Compensation Disclosure Transparency: Evidence From CEO Pay in Acquiring Firms,* 30 J. ACCOUNTING, AUDITING & FIN. 1 (2018).

[104] "Firms with weaker governance offer managers more generous compensation packages to incentivize them. This behavior forces firms with good governance to pay their management more than they would otherwise. This externality reduces the value to firms of investing in corporate governance and produces weaker overall governance in the economy. The effect is stronger the greater the competition for managers." Viral V. Acharya & Paolo Volpin, *Corporate Governance Externalities* (ECGI-Finance Working Paper No. 195, 2008)

influence justifies the skepticism on changes in interpretation. Nevertheless, the enactment of the BIC Law in Colombia provides evidence that change remains possible. Colombian law is not the optimal solution but it promotes the discussion of new ideas and a healthy regulatory competition in corporate law.

With regard to corporate governance, the chapter identified the lack of transparency in executive compensation and explored three opportunities for change that arose with the economic integration. First, companies might be encouraged to voluntarily use compensation as an incentive for sustainable corporate practices, which, according to recent evidence, could increase their competitiveness. Second, an Executive Compensation Code might be created with standards to implement sustainability incentives per industry, following a comply-or-explain strategy. Finally, member states could leverage legal convergence in corporate governance to develop common sustainability standards for executive compensation within domestic jurisdictions

Chapter Three

Simplified Corporations and Entrepreneurship

1. Introduction

In the wake of the twenty-first century, the interest in accelerating economic development through the promotion of entrepreneurship generated an unprecedented wave of corporate law reforms around the world. Most of them follow the "regulation of entry" approach. As adopted by the World Bank's Doing Business project, it encourages the reduction of the procedures, costs, and time to register a business as a means to increase the number of newly registered firms.[1] The project's annual publication has enjoyed an unparalleled global influence, inspiring over 600 corporate law reforms between 2005 and 2018.[2] However, its success in promoting legal convergence in the regulation of entry contrasts with pervasive differences in entrepreneurial activity.[3] From a corporate law perspective, it is an indication that facilitating business registration might be insufficient to promote entrepreneurship.

To compare and evaluate registration schemes, the Doing Business project relies on a problematic definition of "business" that is economically narrow and legally loose. According to it, a business is, on the one hand, a *specific economic entity* that has a minimum number of employees and capital, among other features. On the other hand, it is *any legal entity* granting limited liability and, where there is more than one available, the most commonly used.

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[1] To be sure, the Doing Business Project currently covers eleven topics. This paper focuses on the "Starting a Business" portion, which adopts the regulation of entry methodology, developed by Simeon Djankov et al., *The Regulation of Entry*, 117(1) Q. J. ECON., 1 (2002)

[2] Data available on the World Bank Doing Business website: http://www.doingbusiness.org/

[3] Differences in entrepreneurial activity are accounted by the own Doing Business project, as well as by the Global Entrepreneurship Monitor. *See* Id. and Zoltan Acs et al., *What Does "Entrepreneurship" Data Really Show?,* 31 SMALL BUS. ECON. 265 (2008)

Though legitimate for its own purposes (e.g., facilitate data collection), this decision likely worked against the promotion of entrepreneurship and the correspondent development of corporate law for at least two reasons. First, it might have induced the selection of the wrong legal entity. For entrepreneurs, features such as single ownership or freedom to regulate shares could be even more relevant than the regulation of entry, but are not generally offered by the most common business form (or available at all) and thus excluded from the Doing Business' scope of influence. Second, it might have frustrated the development of corporate law incentives for entrepreneurship. By focusing on easing the registration of the most common entity, the project has not captured how new corporate forms, specifically tailored to address entrepreneurs' needs and preferences, might have stimulated entrepreneurial activity. That the majority of corporate law reforms following the Doing Business approach facilitate access to traditional entities further suggests that it might have diverted attention from these developments.

To gain insights from commonly unobserved legal innovations with economic impact, I propose shifting the emphasis in the analysis of corporate law reforms promoting entrepreneurship. For comparative purposes, a "business" should be *any economic entity* (micro to large), but must be a *specific legal entity* (corporate-type). From an economic perspective, this approach propitiates an evaluation of reforms' influence in the creation of businesses that are excluded from the regulation of entry, despite often being their target. For instance, businesses that do not operate in the country's capital but perhaps in remote locations in need of economic stimulus, or firms that do not hire employees in their first year of operations—e.g. technology start-ups, commonly run by founders in their development stage. Focusing on the differences among legal entities also improves the identification of features that influence entrepreneurs' choices, beyond registration requirements.

Guided by this normative compass, I study two reforms creating new simplified corporate forms in Chile and Colombia in 2007 and 2008, respectively. In both, the main legal innovations are single ownership, freedom to regulate shares, and minimum registration and operation requirements. Governments and business communities have positively gauged the new entities, with the Colombian reform even serving as a regional model under the auspices the Organization of American

States.[4] Nevertheless, their influence in entrepreneurial activity has not been empirically evaluated yet.

To assess the reforms' impact, I built a time series with over a decade of independent data on business registration and conducted multiple differences in differences tests. The results demonstrate that the Chilean reform considerably increased overall firm registration. The surge was predominantly in entities with capital divided into shares, an indication that the reform's complementary incentives for venture capital successfully raised awareness on the benefits of equity finance. The Colombian SAS, in turn, captured the market for business forms within the first year following its introduction. However, the tests do not find a statistically significant effect of the reform in overall registrations, particularly when controlling for changes in labor force. A detailed analysis suggests that drastic migratory and employment fluctuations influenced changes in patterns of business registration.

The tests confirm that, beyond reducing registration requirements, corporate law can meaningfully contribute to entrepreneurship by offering corporate forms with single ownership and a capital structure that facilitates access to equity finance. They also demonstrate that the legal architecture can be strategically leveraged to achieve specific outcomes, such as stimulating investments in private firms.

These lessons are especially useful for emerging economies in Latin America, where the influence of the regulation of entry has shadowed these and other legal innovations. The recent introduction of defective simplified corporate forms in Mexico and Peru illustrates how, in corporate law, the Doing Business eclipses valuable experiences in comparable jurisdictions. Chile and Colombia are not only in the same region but are also strategic partners: in 2011, the four countries founded the Pacific Alliance, an economic bloc that liberalized the movement of people, goods, and services, and integrated their stock exchanges. In this context, the reported results could also contribute to current policy discussions on the legal determinants to entrepreneurship and capital market development.

The paper unfolds in six sections. The first one discusses the restrictive influence of the regulation of entry in the design of corporate law reforms promoting entrepreneurship and economic development. Section two details why single ownership and freely regulated shares are relevant features for

[4] *See* OAS, *Ley Modelo sobre la Sociedad por Acciones Simplificada*, AG/RES. 2906 (XLVII-O/17)

entrepreneurs, and introduces the Chilean and Colombian reforms. Section three presents the data and methodology. The results and implications are presented in section four and five, respectively, leaving the sixth and last section for conclusions.

2. The Restrictive Influence of the Regulation of Entry in Corporate Law

In market economies, entrepreneurship is vital for economic growth and development. To the extent that it implies the creation of new firms, where capital and labor are devoted to advancing a business with the expectation of profits,[5] it can support and accelerate economic development in three crucial aspects. First, by expanding the labor market: founders liberate working positions and new firms tend to create new jobs, even indirectly,[6] notwithstanding motivational and financial differences among entrepreneurs.[7] Second, entrepreneurial activity raises competition for established businesses,[8] influencing improvements in quality and

[5] Despite the lack of consensus on what entrepreneurship comprises and how to properly measure it, the number of incorporations or business start-up rate remains a common factor in global models and comparative indicators that inform policy. *See* Zoltan Acs et al., *supra* note 3 (reaching that exact conclusion, after comparing the two dominant datasets, World Bank and Global Entrepreneurship Monitor). *See also* Nadim Ahmad & Richard G. Seymour, *Defining Entrepreneurial Activity: Definitions Supporting Frameworks for Data Collection* (OECD Statistics Working Paper 1, 2008) (finding that multiple approaches converge in that "entrepreneurship is about the creation of new businesses."), and NIELS BOSMA ET AL., GLOBAL ENTREPRENEURSHIP MONITOR, 2018/2019 GLOBAL REPORT, 10–14 (2018) (reporting similar findings).

[6] Notably, small and medium enterprises (SMEs), the segment that contains most new businesses, employ two-thirds of the world working population. For comprehensive employment data *See* INTERNATIONAL LABOUR OFFICE, SMALL AND MEDIUM-SIZED ENTERPRISES AND DECENT AND PRODUCTIVE EMPLOYMENT CREATION: FOURTH ITEM ON THE AGENDA (2015). *See also* David B. Audretsch & A. Roy Thurik, *Capitalism and Democracy in the 21st Century: from the Managed to the Entrepreneurial Economy*, 10 J. EVOLUTIONARY ECON. 17 (2000) (finding significant evidence of lower unemployment in countries "that have experienced a greater shift from the managed to the entrepreneurial economy.").

[7] In a growing line of research, such differences are used to distinguish necessity entrepreneurs from opportunity entrepreneurs. *See* Zoltan Acs, *How is Entrepreneurship Good for Economic Growth?,* 1 INNOVATIONS: TECH., GOVERNANCE & GLOBALIZATION 97 (2006) (explaining that the former are motivated by the lack of employment alternatives, while the latter make "an active choice to start a new enterprise based on the perception that an unexploited or underexploited business opportunity exists."), and Sander Wennekers et al., *The Relationship Between Entrepreneurship and Economic Development: is it U-Shaped?*, 6 FOUND. & TRENDS IN ENTREPRENEURSHIP 167 (2010) (proposing an alternative categorization, between solo self-employed entrepreneur and "ambitious and/or innovative entrepreneurs," in which only the latter is found to be relevant for policy considerations).

[8] *See* José Ernesto Amorós et al., *Quantifying the Relationship Between Entrepreneurship and Competitiveness Development Stages in Latin America,* 8 INT'L ENTREPRENEURSHIP & MGMT. J., 249 (2012) (compiling empirical evidence of the positive effects of entrepreneurship in competitiveness in the countries of interest for the present work), and Michael Fritsch & Pamela Mueller, *Effects of New Business Formation on Regional Development Over Time*, 38 REGIONAL STUD. 961 (2004) (finding, through a controlled experiment in Germany's regional level, that the effect of new firms in

prices, as well as productivity growth.[9] Finally, entrepreneurship has proven essential for the emergence of innovation, a crucial engine of sustained growth.[10] Whether one defines innovation narrowly (i.e., disruptive technology) or expansively (i.e., improving organizations and finding new markets), new firms are likely to innovate because, among others, they do not have the pressure of serving existing customers and are not bound by established practices.[11] Innovation, broadly considered, is of pivotal relevance for economic development, as it has proven to produce "more economic growth than anything else, including using more resources,"[12] as well as to promote equality through the diffusion of knowledge.[13]

The growing evidence on entrepreneurship's influence in economic development has led to a global upsurge in reforms reducing the legal requirements to register and operate a business.[14] The underlying assumption is that complex and strict regulation to create an entity with limited liability deters entrepreneurial activity, slowing development. De Soto, for instance, found that the legal requirements for firm registration in Peru were so burdensome that they operated as a barrier that excluded the majority of the population from the market, increasing informality and inequality.[15] Djankov et al. presented compelling evidence of a correlation between countries with lower entrepreneurial activity and high

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competition is frequently greater than in employment). For a general theoretical review, *see* PAUL BURNS, *Corporate Entrepreneurship*, *in* ENTREPRENEURSHIP AND SMALL BUSINESS, 493–526 (4TH ED. 2016) (2001)

[9] *See* Stephen J. Nickell, *Competition and Corporate Performance,* 104 J. POL. ECON. 724 (1996) (presenting "evidence that competition, as measured by increased numbers of competitors or by lower levels of rents, is associated with significantly higher rate of total factor productivity growth.").

[10] Innovation comprises people's ability to make new products, processes and, generally, new ideas. A classic overview of innovation and its impact in growth is JOSEPH A. SCHUMPETER, THE THEORY OF ECONOMIC DEVELOPMENT (Redvers Opie trans. 10th Ed., 2004) (1934)

[11] For an empirical analysis on the conditions in which new firms innovate more than established ones, *see* Scott Shane & Riitta Katila, *When are new firms more innovative than established firms?* (University of Maryland Working Paper 1, 2003).

[12] Robert D. Cooter & Aaron Edlin, *Overtaking, in* THE FALCON'S GYRE: LEGAL FOUNDATIONS OF ECONOMIC INNOVATION AND GROWTH, 1–18, 6 (ROBERT D. COOTER ED., 2014) *See also* Robert M. Solow, *Technical Change and the Aggregate Production Function*, 39(3) REV. ECON. & STAT. 312 (1957), and Moses Abramovitz, *Resource and Output Trends in the United States Since 1870,* 46 AM. ECON. REV. 5 (1956).

[13] *See, e.g.,* THOMAS PIKKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY, 72 (2014) (finding that "over a long period of time, the main force in favor of greater equality has been the diffusion of knowledge and skills."), and Andrea Apetrei et al., *The Controversial Link Between Entrepreneurial Activity and Inequality,* 15 INT'L ENTREPRENEURSHIP & MGMT J. 1 (2019) (reaching similar conclusions.).

[14] According to the World Bank Doing Business database, 676 reforms reducing the business registration requirements were implemented between 2005 and 2018, and "the majority of these reforms have been made in low- and lower-middle-income economies." Data available on the World Bank Doing Business website: http://www.doingbusiness.org/en/reforms

[15] Hernando De Soto, *Los costos de la ley*, in EL OTRO SENDERO: LA REVOLUCIÓN INFORMAL, _ (1986)

"regulation of entry;" [16] while Klapper reported that stricter registration requirements limited the growth of certain industries.[17] These and other studies contributed to generate a consensus on the need to facilitate firm registration.[18] The most influential force behind the reforms, however, is the World Bank Doing Business project. Since the first publication of its annual report in 2003,[19] it provides an evaluation and ranking of countries' business registration schemes, based on three categories: *procedures*, which comprise pre-registration interactions between the founders and external parties;[20] *time*, accounted in calendar days and measured from the moment each procedure is initiated until it is fulfilled;[21] and *costs*, including both the minimum capital required to create a new entity, and non-official expenses.

The Doing Business project is a major driver of corporate law reform around the world[22] but has two relevant limitations that are frequently overshadowed by the ranking's notoriety.[23] One of them is that the measured factors are not

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[16] Simeon Djankov et al. *supra* note 1.

[17] Leora Klapper et al., *Business Environment and Firm Entry: Evidence From International Data* (World Bank Policy Research Working Paper No. 3232, 2004).

[18] As illustrated by the increasing number of reforms facilitating registration requirements.

[19] The first Doing Business report presented data collected from of 133 countries in the year 2002. The 2019 report expanded the indicator sets (scope), from 5 to 11, covering 190 economies. *See* World Bank: DOING BUSINESS 2019: TRAINING FOR REFORM (2019)

[20] The index distinguishes three types of procedures: preregistration, which involve name verification and notarization of documents; registration of the articles of incorporation and bylaws, which might be required before different agencies; and post-registration procedures, whose fulfillment is required for operation, such as a social security registration. *See* http://www.doingbusiness.org/methodology

[21] Time is, in fact, an influential measure of a country's business environment, as it is not related to the regulation but to practices and customs. Timothy Besley, who served as independent reviewer of the rakings, acknowledged that "time" was not even measured in many countries before the Doing Business report. *See* Timothy Besley, *Law, Regulation, and the Business Climate: The Nature and Influence of the World Bank Doing Business Project*, 29 J. ECON. PERSP. 99 (2015)

[22] Common reforms include the elimination of public deeds and authorizations by different public authorities (procedures), allowing electronic filling of documents (time), and reduction of the minimum capital requirement (costs). An updated list of reforms is available at http://www.doingbusiness.org/en/reforms

[23] The Doing Business ranking is significantly more influential than the data with which it is elaborated. A recent scandal involving Chile's drop in the ranking illustrates how it can vanish the positive perception of reforms that are successful, according to the index' own standards. *See* ECONOMIST, *Undoing business: The World Bank's "Ease of Doing Business" Report Faces Tricky Questions,* THE ECONOMIST (Jan. 20 2018).

uniformly significant. While there is a strong correlation between registration costs and firm creation,[24] the effect of reforms reducing procedures and time varies.[25]

The second limitation, which is more relevant but has gathered less attention, is the criteria employed to compare the number of newly registered businesses across countries. According to it, a "business" is a *specific economic entity* that operates in the country's capital city and has a minimum number of employees and capital, among other specific characteristics. [26] In contrast, a "business" is *any legal entity* that grants limited liability and, where there is more than one available, the most commonly used.[27]

These methodological limitations have two concrete implications for understanding and designing corporate law incentives to entrepreneurship. On one hand, not all limited liability companies are the same. Certain legal features offered

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[24] The experience in Europe has been particularly useful to measure the effect of reforms, since the *Centros* decision of the (then) European Court of Justice allowed entrepreneurs to choose the jurisdiction to incorporate, regardless of whether it was also the location of headquarters or main operations. In this context, only costs appear to have influenced changes in business registration. *See, e.g.*, Marco Becht et al., *Where do Firms Incorporate? Deregulation and the Cost of Entry*, 14(3) J. CORP. FIN., 241 (2008) (finding that "relatively small differences in minimum capital requirements make a large difference in the rate of new company formation."), and Reiner Braun et al., *Does Charter Competition Foster Entrepreneurship? A Difference-in-Difference Approach to European Company Law Reforms*, 51(3) J. COMMON MAKT. STUD., 399 (2013) (presenting additional econometric evidence that legal reforms eliminating the minimum capital requirement in 5 European countries promoted business registration and entrepreneurship more generally.) *See also* Lars Hornuf & Julia Lindner, *The End of Regulatory Competition in European Company Law?* (Andrássy Working Paper Series No. 33, 2009) (reporting that "after company law reforms had lowered the minimum capital requirement in the home jurisdiction, entrepreneurs no longer needed to switch to foreign company laws.").

[25] *See, e.g.,* Miriam Bruhn, *A Tale of Two Species: Revisiting the Effect of Registration Reform on Informal Business Owners in Mexico,* 103 J. DEVELOPMENT ECON., 275 (2013) (identifying an inconsistent impact of a reform reducing registration times and procedures in Mexico, which varied among municipalities and type of entrepreneur.)

[26] The World Bank's methodology is based on the seminal paper "The Regulation of Entry," which specifies: "For concreteness, we focus on a "standardized" form, which has the following characteristics: it performs general industrial or commercial activities, it operates in the largest city (by population), it is exempt from industry-specific requirements (including environmental ones), it does not participate in foreign trade and does not trade in goods that are subject to excise taxes (e.g., liquor, tobacco, gas), it is a domestically owned limited liability company, its capital is subscribed in cash (not in-kind contributions) and is the higher of (i) 10 times GDP per capita in 1999 or (ii) the minimum capital requirement for the particular type of business entity, it rents (i.e., does not own) land and business premises, it has between 5 and 50 employees one month after the commencement of operations all of whom are nationals, it has turnover of up to 10 times its start-up capital, and it does not qualify for investment incentives." Simeon Djankov et al. *supra* note 1, at 7.

[27] Id. This broad approach persists, despite updates to the methodology. Interestingly, the latest version of the data collection questionnaire includes a section to report situations that might have changed the "most common type of domestic limited liability company." However, it merely collects information on the type of change ("correction, reform, other") and reduction of minimum and/or paid-in capital. *See* http://www.doingbusiness.org/methodology

by different business forms might be equally or more relevant than registration requirements, and the predominant use of a given form might be driven by the interests of influential actors (i.e., notaries, lawyers, accountants) and not by the preferences or needs of entrepreneurs. On the other hand, the framework does not capture the impact of new legal forms that are often specifically tailored to improve the regulatory environment for entrepreneurs. Hence, although the Doing Business project contributed to increasing awareness on the main regulatory burdens to firm creation, it is insufficient to evaluate corporate law reforms promoting entrepreneurship.

Because the legal innovations of simplified corporate forms are in the blind spot of the regulation of entry approach, I propose shifting the emphasis in the definition of "business." Defining a "business" as *any economic entity* but only a *specific legal entity* (simplified corporate form) allows the study of these corporate law incentives and their influence in the creation of new businesses, without considering geographical location or size –qualifications that do not necessarily reflect legislative objectives.

3. Simplified Corporations

3.1. Limited Liability and Equity Finance

Any discussion of business legal forms must consider the corporation, the most prominent one. For many years, it was the only entity that granted founders and investors the benefit of limiting their liabilities to their contributions, promoting riskier business projects.[28] Limited liability also prompted efficient management because the valuation of a firm was no longer determined by the assets of its founders but by corporate performance,[29] an aspect that holds relevant for expansion and growth of contemporary businesses.[30] Corporations have additional

[28] For a comprehensive comparative analysis of the emergence and evolution of corporate law in both origin and transplant jurisdictions, including Chile and Colombia, *see* Katharina Pistor et al., *Evolution of Corporate Law: a Cross-Country Comparison,* 23 U. PA. J. INT'L ECON. L.*,* 791 (2002).

[29] FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW, 42–43 (Harvard University Press 1996) (1991).

[30] *See, e.g.,* Martina Eckardt, *Legal Form and Internationalization of Small and Medium-Sized Enterprises in the EU* (Andrássy Working Paper Series No. 31, 2014) (finding, from a performance analysis of 9,480 European small and medium size enterprises, that firms with limited liability –as

advantageous attributes over other business forms. For instance, legal personality allows continuity in time, regardless of the decease or exclusion of founders or investors, reducing transaction costs[31] as well as the cost of credit;[32] and delegated management under a board structure facilitates and promotes improvements in the quality of business decisions.[33] Remarkably, a corporation's capital is divided into marketable shares that can be issued and sold to capitalize the firm, a practice known as equity finance.[34] Share transferability significantly improves the business' financing and growth opportunities by allowing it to access funds from investors who might not be interested or willing to be involved in managerial decisions, but to purchase and sell rights to future profits in different firms.[35] Although transferability is often restricted in private corporations via bylaws and shareholder agreements, it is the default legal arrangement distinguishing it from other types of business forms that do not even allow it, such as partnerships.

Due to the benefits associated with limited liability and equity finance, creating (incorporating) a corporation has been traditionally more expensive than other business forms, making it less accessible, even today. The corporation is the first—and to an extent remains the only—business legal entity with completely separate rights and obligations from its founders,[36] which initially meant that its

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opposed to unincorporated– had a positive impact "on internationalization, independent of firm size effects.").

[31] Notably, the cost of engaging and amending contracts. *See* MICHAEL C. JENSEN, A THEORY OF THE FIRM, 88 (2000).

[32] These benefits derive from what Hansman and Kraakman call "affirmative asset partitioning," which is inherent to the concept of juridical person or legal entities: "The type of affirmative asset partitioning that we see in the business corporation can be termed "priority with liquidation protection." It not only assigns to the corporation's creditors a prior claim on corporate assets, but also provides that, if a shareholder becomes insolvent, the shareholder's personal creditors cannot, upon exhausting the shareholders' personal assets, force liquidation of corporate assets to satisfy their claims." Henry Hansmann & Reiner Kraakman, *The Essential role of Organizational Law*, 110 YALE L. J. 387, 394 (2000)

[33] *See* John Armour et al. *What is a Corporation?, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, 1–28 (John Armour , Luca Enriques et al., 3rd ed. 2017) (2009).

[34] "The corporation is a decisive improvement in financing innovation because investors receive a marketable share of future profits. In contrast, a personal organization provides no mechanism to guarantee investors a fraction of its future profits, and a partners' rights in a firm are not freely marketable." ROBERT D. COOTER & HANS-BERND SCHÄFER, SOLOMON'S KNOT: HOW LAW CAN END THE POVERTY OF NATIONS, 127 (2011)

[35] The practice, commonly known as portfolio investment, reduces investment risk as well as firms' cost of capital. One of the most influential accounts of how shares maximize capital allocation efficiency for both firms and investors is in Henry J. Manne, *Our Two Corporation Systems: Law and Economics,* 53 VA L. REV. 259 (1967).

[36] Jonathan R. Macey & Leo E. Strine, *Citizens United As Bad Corporate Law* (U. Pa Institute for L. & Econ. Research Paper No. 18–28; Yale L. & Econ. Research Paper No. 598, 2018).

existence required state approval or *concession*.[37] The conditions and costs that persisted after incorporation was liberalized have multiple justifications. For instance, they might serve the state's interest in controlling corporations' involvement in economic activities or protect non-adjusting creditors, who might only pursue corporate assets in case of default.[38] Incorporation costs could also guarantee minimum business quality standards, hampering market access to individuals who decide to start a firm out of necessity and not because they identified a business opportunity.[39] Moreover, they might allow the state to collect fees and to strategically stimulate demand for professional services.[40]

Besides registration costs and procedures, corporations must adjust to stricter and more costly governance standards in most jurisdictions, including the designation of an independent audit and a board of directors. These costs, in turn, could be justified in the protection of uninformed investors from insiders' (managers or controlling shareholders) opportunistic behavior.[41]

Albeit justifiable in the protection of other interests, the high costs of incorporation and governance of corporations deter entrepreneurship, by restricting the access to limited liability and equity finance.

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[37] Katharina Pistor et al., *Evolution of Corporate Law, supra* note 28, at 806. (describing that "until well into the 19th century, the allocation of control rights among the shareholders of the corporation was secondary to the reservation of control by the state. The state's veto power over incorporation can be traced to the incorporation of state-chartered companies in the Middle Ages.")

[38] Braun et al. summarized the findings of the main economic literature in the following terms: "Regulatory costs may be justified by countervailing benefits because the registration process can serve as a screening process. Restricting start-up activity can protect uninformed creditors and reduce information asymmetries… More specifically, minimum capital requirements may sort out 'necessity nascent entrepreneurs' who start a business only to escape unemployment. Such entrepreneurs are less wealthy …and therefore more strongly affected by registration costs… At the same time, they have been shown to have no beneficial effect on technological development… Stricter requirements can thus help to prevent market failures, as the 'public interest theory of regulation' contends…". Reiner Braun et al., *supra* note 21, at 401–402. *See also* Djankov et al., *supra* note 1.

[39] *See* Mohammad Amin, *Obstacles to Registering: Necessity vs. Opportunity Entrepreneurs* (World Bank Res. Paper No. 53032, 2009) (presenting evidence that registration requirements have a higher impact on necessity entrepreneurs than on opportunity entrepreneurs).

[40] *See* Jonathan R. Macey, *The Limited Liability Company: Lessons for Corporate Law*, 73 Wash. U. L. Q. 433, 440 (1995) (noting that registration of business entities, in general, "creates a need for the cadres of white collar bureaucrats necessary to process the requisite corporate forms. And, of course, the filing requirement creates artificial demand for the services of the lawyers who prepare the papers that must be filed in order for a firm to achieve limited liability status.").

[41] For an overview of the agency problem between corporate investors and insiders, as well as alternatives strategies to mitigate them, *see* John Armour et al. *The Basic Governance Structure: The Interest of Shareholders as a Class, in* THE ANATOMY OF CORPORATE LAW. A COMPARATIVE AND FUNCTIONAL APPROACH, 49–78 (John Armour , Luca Enriques et al. 3rd Ed. 2017) (2009).

In Latin America, excessively high costs ensured that only a minimal minority could access the corporate form. Mainly, foreign firms[42] and wealthy families, who gradually controlled dominant business groups.[43] The constrained access to the corporate form diminished the region's potential to foster entrepreneurship and enjoy the benefits associated with it.[44] Instead, it appears to have contributed to increasing inequality and to the rise of an informal economy of the likes described by De Soto. Illustrative of it is the percentage of firms competing against unregistered or informal businesses, which, according to the 2010 World Bank Enterprise Survey, were above the 53.5 world average, even in the region's most liberal economies: Chile (55.8), Colombia (70.9), Mexico (70.3), and Peru (68,6).[45] Informality is not only the basis of uneven competition but further restricts economic development, by limiting informal businesses' access to finance and

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[42] "Foreign firms, mostly from the United States, made massive direct investments in Latin America throughout the twentieth century… By the 1970s the foreign share of manufacturing was 24 per cent in Argentina, 50 per cent in Brazil, 30 per cent in Chile, 43 percent in Colombia, 44 percent in Peru and 14 per cent in Venezuela. The percentages were usually higher in sectors like chemicals, electrical equipment and transport equipment than in consumer non-durables like food, beverages, textiles and clothing. By 1995, by another calculation, the stock of [foreign direct investment] as a percentage of GDP was on average 16 percent for the four largest countries of Latin America (compared to 2 per cent for South Korea and 10 per cent for Thailand). [Multinational corporations—MNCs] presence was especially visible among the largest firms. The share of MNCs in the sales of the 500 largest companies in the region ranged between 30 and 40 per cent for most of the 1990s and 2000s." Ben Ross Schneider, *Hierarchical Market Economies and Varieties of Capitalism in Latin America,* 41 J. LATIN AM. STUD. 553, 560 (2009)

[43] An extreme example of the high costs of incorporation is Chile, where, until 1981, "two presidential decrees were required for a company's complete incorporation: one authorizing incorporation, the other verifying lawful incorporation and allowing the commencement of business." Pistor et al., *Evolution of Corporate Law supra* note 28, at 844. *See also* José Miguel Mendoza, *The Political Economy of Capital Markets in Latin America* (2014), http://dx.doi.org/10.2139/ssrn.2394781 (last visited Nov. 15, 2019) (showing that the dominance of family-controlled groups might have also prevented capital market development in Latin America), and Schneider, *Hierarchical Market Economies, supra* note 42 (arguing that, despite discouraging entrepreneurship, dominance of family groups contributed to economic stability in Latin America).

[44] In Mexico, for instance, there is evidence that unincorporated businesses are exposed to higher risks and tend to remain small. *See* Luc Laeven & Christopher Woodruff, *The Quality of the Legal System, Firm Ownership, and Firm Size*, 89 REV. ECON. & STAT., 601 (2004)

[45] *See* WORLD BANK , ENTERPRISE SURVEY (2010). More recent data shows improvements in Colombia (66.1) and retreats in Peru (75.9), which suggests that Colombian reforms might have had an impact on informality. In historical perspective, the reduced number of registered firms (which are also the result of an underdeveloped business legal culture) might also explain how a handful of family groups accumulated business experience and market dominance, at the expense of new market participants. *See* Katharina Pistor & Daniel Berkowitz, *Of Legal Transplants, Legal Irritants, and Economic Development*, *in* CORPORATE GOVERNANCE AND CAPITAL FLOWS IN A GLOBAL ECONOMY, 347–370, 350 (Peter Cornelius & Bruce Kogut eds., 2003) (showing that during the nineteenth century, "only a few large companies were operating in [Colombia,] and most had been chartered under imperial Spanish rules that applied in Latin America prior to the dissolution of the Spanish empire.")

enforcement of contracts, weakening their growth capabilities.[46] Moreover, it reduces tax collection and, indirectly, government spending.[47] These concerns permeated discussions on the potential benefits of alternative corporate forms, even before the emergence and dominance of the regulation of entry, due to the success of the Limited Liability Company (LLC) in the United States.

Since its spread throughout the United States in the 1990s, the LLC offers a cheaper alternative to the corporation, unleashing a global trend toward more flexible business entities with different outcomes.[48] Despite not being specifically designed for equity finance,[49] the LLC granted the benefit of limited liability with

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[46] *See* Rafael La Porta & Andrei Shleifer, *The Unofficial Economy and Economic Development,* 47 BROOKINGS PAPERS ECON. ACTIVITY 123 (2008) (presenting evidence that formal firms have higher productivity levels in multiple jurisdictions), and Mauricio Cárdenas & Sandra Rozo, *La Informalidad Empresarial y sus Consecuencias: ¿Son los CAE una Solución?* (Fedesarrollo Working Paper Series No. 38, 2007) (showing that, in Colombia, informal businesses have, on average, less access to credit and training programs, greater problems with technical services and lower profits per worker compared to formal companies with similar characteristics.) *See also* Tor Jansson & Geoffrey Chalmers, *The Case for Business Registration Reform in Latin America* (Sustainable Development Best Practices Series, MSM 110, 2011), and Subika Farazi, *Informal Firms and Financial Inclusion: Status and Determinants*, 5 J. INT'L COM., ECON. & POL'Y 1 (2013)

[47] For an overview of the informality debate in Latin America, and common policy reactions, *see* Cathy Rakowski, *Convergence and Divergence in the Informal Sector Debate: A focus on Latin America, 1984–92*, 22 WORLD DEV. 501 (1994)

[48] To be sure, the first statute was enacted in Wyoming in 1977 and gradually adopted by other states. For a detail account of the legislative process and its impact in the proliferation of LLC statutes across the US, *see* William J. Carney, *Limited Liability Companies: Origins and Antecedent*, 66 U. COL. L. REV. 855 (1995). *See also* Francisco Reyes & Erik Vermeulen, *Company Law, Lawyers and "Legal" Innovation: Common Law versus Civil Law,* 28 BANKING & FIN. L. REV. 433, 446 (2013) (noting that "after 1990, LLC legislation swept rapidly through the United States, largely because of competitive pressures and lobbying activities by domestic interest groups, more specifically corporate lawyers expecting additional clients and work from the LLC. LLC provisions have been adopted in all 51 U.S. jurisdictions by the close of 1996."), and Joseph McCahery et al., *A Primer on the Uncorporation*, 14 EUR. BUS. ORG. L. REV. 305, 307 (2015) (finding that the proliferation of non-listed business forms, on a broader comparative scope, has "been shaped by a mixture of learning and professional advice arising from the company law review process, as well as the indirect influence of overseas business forms," in which the US LLC has been preponderant.).

[49] In fact, historical evidence demonstrates that the LLC was, mostly, an attempt to offer pass-through taxation to closely-held corporations. Law professor Susan Pace Hamill, who served in the Chief Counsel's Office of the Internal Revenue Service (IRS) when LLC reforms were discussed, wrote a thorough historical account on LLC statutes. In relevant part, she noted that "the LLC's more recent origins come from the twentieth century's disparate business tax regime accorded partnerships and corporations, the comparative tax burdens of doing business in those forms arising out of that system, and the peculiar policies of the IRS concerning the impact of statutory limited liability on the ability to achieve partnership classification. The IRS singlehandedly prevented LLC experimentation before 1960, and, through its own regulations, set the legal stage for the LLC's invention after 1960. Once the legal landscape allowed for the combination of limited liability and partnership classification, the LLC could emerge." Susan P. Hamill, *The Origins Behind the Limited Liability Company,* 59 OHIO ST. L. J. 1459, 1519 (1998).

less strict governance standards.[50] Notably, freedom to contractually regulate management, boards, meetings, and dissenters' rights,[51] which are subjected to fixed rules in corporations.[52] Most importantly, LLCs can be taxed as partnerships, as long as they lack two of four corporate elements: perpetuity, free transferability of interests, centralized management, or limited liability.[53] Its success in the US, energized an ongoing global wave of reforms creating or amending legal forms, with relevant differences that tend to be overlooked when focusing on limited liability and entry requirements.

3.2. Single Ownership and Freely Regulated Shares

In a functional comparative analysis, McCahery et al.[54] developed a binary classification of alternatives to the corporate form (or "uncorporations") that is useful to understand the differentiated impact each of them had. On one end, the "partnership-type" forms, which grant the benefit of pass-through tax treatment but, by default, require unanimous approval for interest transferability, and profits and loses to be distributed evenly among the members (equal sharing rule.) On the other end, the "corporate-type" forms, which, despite being taxed as corporations, can have a single owner, do not legally restrict share transferability and expand the freedom to regulate economic rights. From their analysis, it is conspicuous that all alternative forms offer limited liability and, compared to the traditional corporation,

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[50] To some extent, flexibility (or higher private ordering) was a return to notions of the closely-held business entities that, despite being popular for a significant period, vanished with the dominance of the public corporation in most of the twentieth century: "the LLC represents a fairly close approximation of the unincorporated joint-stock company that developed in England in tandem with, and as a substitute for, the royally chartered corporation. We have evidence of the widespread employment of the joint-stock company in the United States in the eighteenth and nineteenth centuries. The distinctive feature of these entities, except for limited liability, is the notion of private ordering rather than government regulation, which dominates much of our thinking about corporations." Carney, *supra* note 45, at 856. For a broader comparison of the LLC to other types of business associations, *see* Robert Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity,* 47 BUS. L. 375 (1992).

[51] J. William Callison, *Venture Capital and Corporate Governance: Evolving the Limited Liability Company to Finance the Entrepreneurial Business,* 26 J. CORP. L. 97 (2000).

[52] John Armour et al., *supra* note 30.

[53] "[I]n order for an entity such as a limited liability company to qualify for pass-through tax treatment, and thereby avoid the double taxation of distributions, the entity must possess more "noncorporate characteristics" than "corporate characteristics."…The applicable U.S. Treasury Regulations provide that a firm is a corporation rather than a partnership if it has three of the following characteristics: (1) continuity of life; (2) free transferability of interests; (3) centralization of management; and (4) limited liability." Jonathan R. Macey, *supra* note 37, at 434-435

[54] McCahery et al., *supra* note 48.

a more flexible structure with opt-out rules. However, only the corporate-types permit single ownership and greater autonomy to design the capital structure via the issuance of multiple classes of shares. The latter explains why they have been increasingly preferred by new businesses, even without tax benefits.[55] It is thus worth briefly reviewing these two corporate-type features.

The recognition of single ownership is possible due to a crucial and unique characteristic of the corporation. Unlike partnerships, the corporation exists as a separate legal entity with its own rights and obligations because the law authorizes it and not as a result of the amalgamation or association of individuals' rights. This approach is consistent with the historical evolution of corporate law (from concession to "free" incorporation),[56] and is grounded in the prevailing economic theories of the corporation,[57] providing superior theoretical coherence.[58] Hence, the statutory requirement of a plurality of founders for incorporation must be interpreted as a legislative choice and not as an essential characteristic of the corporation.

Removing the multiple-shareholder requirement, even if only for specific simplified forms, could significantly contribute to increasing corporate law's

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[55] "[T]he corporate-type uncorporate forms in France and Colombia, which are both treated as corporations for fiscal purposes…have become the most favorable choice of entity for non-listed firms for other considerations than a more beneficial tax status. Indeed, the driving force behind uncorporations is often the concept of maximum flexibility and autonomy of the business parties (and their corporate lawyers) to structure the firm's internal affairs as much as possible free from the establish legal principles and doctrines…. [Even though the French] SAS does not provide a detailed set of default rules that could easily fill the contractual gaps for the parties' omissions… the SAS is perhaps the most entrepreneur-friendly uncorporation in Europe today that is also available to individuals." McCahery et al., *supra* note 48, at 23.

[56] Katharina Pistor et al., *supra* note 28, at 794 (noting that "[t]he evolution of corporate law at the end of the 19th century demonstrates that [competition] is not an isolated phenomenon, as is evidenced by the erosion of the concession system in France and subsequently in Germany. France responded to the competitive "threat" of companies that were allowed to freely incorporate in England by moving from the concession to the free registration system, and Germany soon followed suit."). These changes in the so-called origin legal systems, inspired most reforms in emerging economies, such as Chile and Colombia.

[57] In a recent study, Chief Justice of Delaware Supreme Court, Leo E. Strine, and legal scholar, Jonathan R. Macey, discussed the main economic and legal theories of the corporation, concluding that "it is precisely because corporations are distinct from, and cannot be relationally considered as an association of any of them, that theorists like Berle, Friedman, Easterbrook and Fischel, and Bebchuk have spent so much time considering how to constrain the power of corporate management," which remains on the center of contemporary corporate law scholarship. Jonathan R. Macey & Leo E. Strine, *supra* note 33, at 35–36.

[58] Id., at 61–85. (explaining why the alternative (corporations as associations) led the Supreme Court of the United States to a ruling that contradicts the historical evolution of corporate law in case law, as well as in legal and economic theory.)

influence in entrepreneurship. Single ownership could promote business formalization, allowing founders to protect their assets without requiring a business partner. It could also propitiate the expansion of consolidated businesses through the creation of separate, yet fully controlled, legal persons. Some commentators warn that it might facilitate abusive uses of the corporate form, but experience demonstrates that a clear exemption to limited liability in those cases (lifting the corporate veil) deters fraudulent behavior,[59] and might even propitiate the –often-elusive– development of case law. An additional concern is that it might overexpose creditors, who could assume that multiple founders have capitalized the business or even pursue shareholders' assets in extreme circumstances. However, single ownership is more likely to promote transparency and enhance creditor protection, by more accurately identifying companies' ownership structure to the market and discouraging *de facto* single-owned entities. [60]

The freedom to issue multiple classes of shares was the second characteristic identified in corporate-type alternative forms. The possibility of assigning various rights and obligations to different classes of shares gives founders and investors the ability to negotiate and amend the terms of mutually beneficial agreements that might be impossible under other business entities or under strict corporate law regulation. [61] Multiple classes of shares are a fundamental component of contemporary equity finance of private firms [62] and, more generally, of an innovation-driven economic development strategy.[63]

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[59] For an overview of the debate, with a focus on Colombia, *see* OSCAR H. GONZÁLEZ BENJUMEA, SOCIEDAD POR ACCIONES SIMPLIFICADA. INNOVACIONES LEGISLATIVAS, DOCTRINALES Y DESARROLLO JURISPRUDENCIAL (2012).

[60] Absent the option of a single-owner company, entrepreneurs (and established businesses) often resort to incorporate the new entity with a disengaged co-founder, who might be a family member or a close friend with no real connection to the business. This uncomfortably common practice overly exposes creditors, who –in principle– rely in legal capital as a guarantee and, on extreme circumstances, on some of the multiple shareholders' assets. Paradoxically, some critics of single-owned corporations emphasize that it increases creditor vulnerability, without considering the factual pattern just described. *See* Kimberly B. Yu & Richard Krever, *The High Frequency of Piercing the Corporate Veil in China,* 23 ASIA PAC. L. REV. 63 (2015) (discussing the misconceptions on the relationship between single ownership and creditor protection, in an analysis of similar legal reforms in China).

[61] *See* Thomas Hellmann, *The Allocation of Control Rights in Venture Capital Contracts,* 29 RAND J. ECON. 57 (1998) (showing how multiple classes of shares propitiate efficient distributions of control rights), and Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts,* 70 REV. ECON. STUD. 281 (2003) (providing empirical evidence).

[62] The literature on this subject is as ample as the possibilities that emerge from the freedom to create individualized shares. For complementary approaches, *see* Zenichi Shishido, *Does Law Matter*

The experience in Latin America further indicates that partnership-type forms, widely preferred for historical reasons,[64] are not the best corporate law strategy to promote entrepreneurship in developing and emerging economies. First, such alternatives to the corporate form did not offer a significant reduction in the costs to access limited liability.[65] Second, they did not allow for single-ownership or equity finance. Before the US LLC trend, most Latin American jurisdictions offered a partnership-type alternative to the corporate form that did not reduce informality or promoted entrepreneurship, potentially because they still required a plurality of founders and members' approval of any transfer of an interest in the entity.[66] Third,

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to Financial Capitalism? The Case of Japanese Entrepreneurs, 37 FORDHAM INT'L L. J. 1087 (2014), Francesca Cornelli & Oved Yosha, *Stage Financing and the Role of Convertible Securities*, 70 REV. ECON. STUD. 1 (2013), Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067 (2003), and Paul Gompers & Josh Lerner, *The Venture Capital Revolution*, 15 J. ECON. PERSP. 145 (2001).

[63] By contributing to resolve the "double-trust dilemma of innovation" (or general distrust between innovators and financiers), multiple shares can facilitate the financing and development of innovations in markets and organizations. According to Cooter and Schäfer, the double-trust dilemma is one of the main barriers to an innovation-driven economy in both developed and developing countries. *See* ROBERT D. COOTER & HANS-BERND SCHÄFER, *supra* note 34, at 27–38.

[64] *See* Francisco Reyes, *Modernizing Latin American Company Law: Creating an All-Purpose Vehicle for Closely Held Business Entities-The New Simplified Stock Corporation*, 29 PENN ST. INT'L L. REV. 523, 524 (2010) (explaining that "[c]ompany law in most Latin American jurisdictions continues to follow the taxonomy of business associations inherited from the nineteenth century's French codification movement. The point of departure for these systems can be found in the Code Civil and Code de Commerce of 1804 and 1807, in which the basic types of companies were included."), and Pistor et al., *supra* note 28, at 843 (offering a broader overview of the historical origins of legislative preferences: "After 1815, an independence movement swept Latin America. New states were formed and constitutions adopted, which were modeled after the French constitution of the First Republic, or the U.S. constitution, or a combination of both. The enactment of civil and commercial law was delayed until mid-century in most of the newly independent states."). *See also* Phanor J. Eder, *Company Law in Latin America,* 27 NOTRE DAME L. REV. 5 (1951).

[65] Comparatively, Latin American countries had more registration procedures in the first World Doing Business, which captures requirements applicable to most entities. The traditional alternative to the corporate form is the *sociedad de responsabilidad limitada* (limited liability company), which required public deed, registration before certain authorities, and, in some cases, publication. Because of its cumbersome registration requirements, certain scholars classified it as a "solemn" business entity form, highlighting that procedural requirements where part of the essence of the entity and indispensable for its creation. A common account in Chile is in CARLOS G. VILLEGAS, TRATADO DE LAS SOCIEDADES, 269 (1996). Statutory provisions in the countries of interest: Chilean Ley 3.918 (1923); Colombian Code of Commerce, Articles 110–116; Mexican General Law of Mercantile Companies, Chapter VI; and Peruvian General Law of Business Organizations, Book I and III.

[66] Illustrative of it are articles 58 and 61 of Mexican General Law of Mercantile Companies, which respectively require a minimum of two founders and a maximum of 50 members. Article 65 of the same statute provides that "for the transfer of interests in the entity, as well as for the admission of new members, the consent of the partners representing the majority of the share capital will suffice, unless the bylaws provide a higher proportion." For complementary accounts on the development of corporate law in Latin America, *see* Reyes, *supra* note 60, Pistor et al., *supra* note 28, and Eder, *supra* note 60.

partnership-types do not specifically offer a preferential tax treatment similar to the one that drove their success in the United States.[67] In some cases, the alternative to the corporation even had weaker limited liability.[68] Table 3.1 displays the relevant differences in Colombia.

Table 3.1. Private Corporation v. Limited Liability Company in Colombia

	Private Corporation	**Limited Liability Company**
Limited liability	- Yes.	- Yes, *but* with relevant exceptions.[69]
	Art. 98	*Art. 353*
Equity	- Yes.	- No.
(transferable shares)	*Art. 374-390*	*Art. 354*
Single ownership	- No. Minimum five.	- No. Minimum 2.
	Art. 374	*Art. 98*
Freely regulated shares	- No.	- No.
	Art. 374-390	*Art. 354*

NOTE*: All referenced articles are in the Commerce Code.*

[67] *See* Vito Tanzi, *Tax Reform in Latin America: A Long Term Assessment* (CEQ Working Paper No. 15, 2013) (showing that tax incentives in Latin America have been introduced through general tax reforms to promote certain economic outcomes rather than through the use of specific business forms), Rodrigo Cerda & Felipe Larraín, *Inversión Privada e Impuestos Corporativos: Evidencia para Chile*, 42 CUADERNOS DE ECONOMÍA 257 (2005) (asserting that, in fact, the traditional corporate form in Chile had a higher income tax rate than the alternative for a long time, before the rates were equated in 1986), and Mauricio Olivera, *Tasas Marginales Efectivas de Tributación en Colombia*, (CEPAL, Estudios e Investigaciones No. 34280, 1996) (noting that, in Colombia, except for the period 1953–1960, the corporate form was subjected to a higher income tax rate, but it was also equated with the alternative form in 1992). In Mexico, the tax legislation does not even distinguish business entities but includes all of them in the broad category of *moral persons*. In this regard, *see* Mexican Income Tax Law, article 7, and the analysis by Abigail Rodríguez & Camelina Ruiz, *Contribución efectiva al Impuesto Sobre la Renta en personas morales del régimen general*, 38 ECON.: TEORÍA Y PRÁCTICA 9 (2013). In Peru, small and medium enterprises can benefit from certain tax incentives, regardless of the legal form that they adopt, pursuant to a legislative authorized decree. *See* Decreto Supremo Nº 007-2008-TR - Texto Único Ordenado de la Ley de Promoción de la Competitividad, Formalización y Desarrollo de la Micro y Pequeña Empresa y del Acceso al Empleo Decente (Ley MYPE), article 4.

[68] In Colombia, members of an LLC can be liable for specific duties, such as labor or tax. *See* Ley 222 (1995), article 163; Labor Code, Articles 353–355; and Colombian Commerce Code, article 356.

[69] Id.

3.3. Chilean SpA and Colombian SAS

The simplified corporate forms introduced by Chile and Colombia in the first decade of the new millennium, provide cheaper access to both limited liability and equity finance, by eliminating the main regulatory burden (public deed) for the creation of a private corporation. These new entities can also have a single owner and freely regulated shares, making them ideal for testing their effectiveness as corporate law incentives to entrepreneurship.

Chile created the *Sociedad por Acciones* (SpA) through Law 20.190, enacted in May 17 of 2007 and in force since June 5 of the same year. [70] The SpA offers limited liability protection to single founders and specifically provides that the capital is divided into shares that are freely negotiable unless otherwise stipulated in the bylaws.[71] Founders are also entitled to create multiple classes of shares and regulate the rights assigned to each of them. In relevant part, the law established that the SpA is created with the signed articles of incorporation, and specifies that they can be written in a public deed or—remarkably—in a private document. [72] The law did not address other burdensome registration procedures, such as the publication note of the registration of the entity.[73] Still, removal of the public deed requirement meant a reduction of up to four days[74] and costs of around $250 in registration,[75] which, in addition to single ownership and equity finance, justified the high expectations it generated as an engine for entrepreneurship.[76]

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[70] An updated version of the law is available at https://www.leychile.cl/Navegar?idLey=20190

[71] Article 444 of the Chilean Commerce Code, amended by article 17 of Ley 20.190 (2007), provides that the SpA is "a legal entity created by one or more persons…whose participation in the capital is represented by shares."

[72] Article 425 of the Chilean Commerce Code, amended by article 17 of Ley 20.190 (2007)

[73] In Chile, the default incorporation procedure is in article 5 of its corporate statute, Ley 18.046 (1981), which provides that "an extract from the public deed, *authorized* by the respective notary, must be *registered* in the Commercial Registry corresponding to the company's address and *published* only once in the Official Gazette." (emphasis added)

[74] Maria F. Vásquez Palma, *Intentos Modernizadores En El Derecho Societario Chileno: Análisis De Las Leyes 20.494 y 20.659,* 21 REVISTA DE DERECHO COQUIMBO 353 (2014)

[75]According to an independent study by Transtecnia, the costs are around 200.000 Chilean pesos, which is equivalent to approximately $250 with historical exchange rates. *See* TRANSTECNIA, *Boletín Informativo 291*, TRANSTECNIA (Jan. 20 2014) https://www.transtecnia.cl (last visited Jun. 15, 2019)

[76] The expectations were particularly high for the government. *See* Andres Jara, *Sociedades Por Acciones, Ley 20.190: Publicada en el Diario Oficial con Fecha 5 de Junio de 2007*, 34 REVISTA CHILENA DE DERECHO 381 (2007) (noting, in an account of the legislative history, that Law 20.190 was part of a broader policy aimed at promoting entrepreneurship and stimulating the venture capital industry, which was a crucial component of the government's economic agenda.)

Through Law 1258 (2008), Colombia introduced its new corporate form, the *Sociedad por Acciones Simplificadas* (SAS), in force since December of that year. The SAS also eliminated the public deed requirement, making it possible to incorporate with the registration of a private document containing the articles of incorporation in the Mercantile Registry.[77] The new entity allows single ownership, freedom to issue and regulate different classes of shares, as well as complete flexibility to define the governance through opt-out rules giving full powers to single founders.[78] In spite of the prolonged legislative debate preceding its enactment,[79] the SAS changed incorporation patterns in Colombia: in its first year, half of all newly registered businesses adopted the SAS form.[80]

Although at a different pace and intensity, both the SpA and the SAS became the dominant legal forms in each country. In 2018, over half of newly Chilean registered businesses adopted the SpA form.[81] In Colombia, the SAS seized almost the entire market in a short period,[82] capturing the attention of the international community.[83] While positive, these changes do not conclusively demonstrate whether the reforms influenced the decision of entrepreneurs who would not have registered a business in their absence. The lack of certainty in this regard, which

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[77] Law 1258 (2008), article 5: "The simplified corporation shall be created through a contract or a unilateral decision, that must be consigned in a private document filed before the Mercantile Registry.").

[78] For a thorough explanation of these and other features of the SAS, see Francisco Reyes, *supra* note 60, at 523 (accurately describing it as an "all-purpose vehicle for closely held business entities."). For an updated analysis on the impact of these legal innovations, *see* Aurelio Gurrea-Martínez, *The Colombian Simplified Stock Corporation as an Example of Legal Innovation: Thoughts About the Role of Legal Scholars* (Instituto Iberoamericano de Derecho y Finanzas (IIDF) Working Paper Series No. 2, 2018). For a critical approach, *see* FELIPE CUBEROS DE LAS CASAS, SOCIEDAD POR ACCIONES SIMPLIFICADA (SAS): NOVEDADES, ACIERTOS Y DESACIERTOS (2012).

[79] The first attempt to introduce the simplified corporate form through legislation was rejected by the Senate in the period 2006–2007, due to lack of legal and economic justification. Critics noted that single ownership was inconsistent with traditional legal theory and that eliminating registration formalities could overly expose creditors. For an account of the legislative process, *see* Carlos A. Arcila, *Sociedad por Acciones Simplificada*, 8 REVISTA E-MERCATORIA 1 (2009).

[80] Francisco Reyes, *The Colombian Simplified Corporation: An Empirical Analysis of a Success Story in Corporate Law Reform,* 4 PENN ST. J. L. & INT'L AFF. 392 (2015), and McCahery et al., *supra* note 48, at 338.

[81] According to the January 2019 report of the Chilean Ministry of Economy, 132,140 businesses registered in 2018 (both electronically and through traditional process) from which 74,195 where SpAs (56.1%). *See* MINISTERIO DE ECONOMÍA FOMENTO Y TURISMO, *Informe Mensual de Constitución de Empresas y Sociedades*, Enero 2019, MINISTERIO DE ECONOMÍA FOMENTO Y TURISMO (Jan. 2019) https://www.economia.gob.cl/wp-content/uploads/2019/02/Informe-RES-enero-2019.pdf (last visited Jun. 15, 2019)

[82] Since 2010, over 95% of new businesses adopt the SAS form. CONFECAMARAS, INFORME DE COYUNTURA EMPRESARIAL 2012 (2013). *See also* Francisco Reyes, *supra* note 76, and McCahery et al., *supra* note 45.

[83] *See* OAS, *supra* note 4 (establishing the SAS as a regional model statute).

cannot be resolved with the Doing Business framework or dataset, motivates the hypothesis to test: did the reforms influence overall business registration?

Table 3.2: Corporation v. Simplified Corporations in Chile and Colombia

	Chile		Colombia	
	Private Corporation	**SpA**	**Private Corporation**	**SAS**
Incorporation	- Public deed - Registration in commercial registry - Publication in official gazette *Arts.3-5*	- Private document - Registration in commercial registry - Publication in official gazette *Arts. 425-26*	- Public deed - Registration in commercial registry *Arts. 110-11*	- Private document - Registration in commercial registry *Art. 5*
Single Ownership	- No. Minimum 2 *Art. 1*	- Yes *Art. 424*	- No. Minimum five *Art. 374*	- Yes *Art. 1*
Regulation of shares	- Law determines the types of shares that can be issued *Arts. 10-30*	- Freedom to create and regulate shares in bylaws Arts. 436-39	- Law determines the types of shares that can be issued *Art. 374-390*	- Freedom to create and regulate shares in bylaws *Arts. 10-15*
Source	Law of Corporations Law 18.046 (1981)	Commerce Code, as amended by Law 20.190 (2007)	Commerce Code	Law 1258 (2008)

4. Data and Methodology

4.1. Data

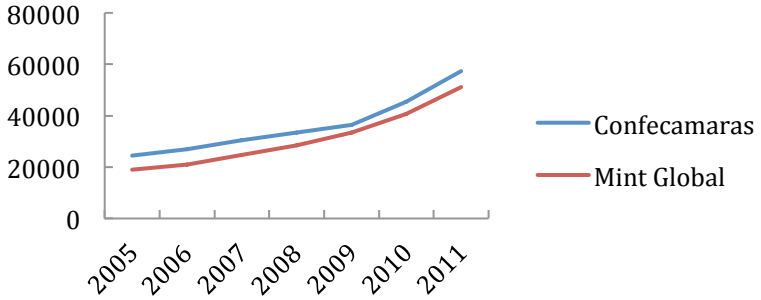
The main variable of the test is the number of incorporations per year. I used the database of Mint Global because it was the best alternative to domestic registry. Although the latter was ideal, it was only available for periods that do not coincide with the one of interest. Mint Global is the ORBIS database equivalent for companies from around the world, collecting financial information of over 50 million

companies from 210 countries.[84] It is also published by Burau Van Dijk, commonly used in similar studies.[85]

To test the reliability of Mint Global's database, I compared it to the entire universe in specific periods that I was able to access. In the case of Colombia, the National Federation of Chambers of Commerce (Confecamaras) kindly shared with me the complete business registration data for the period 2005-2016. Since 2013, the Chilean Ministry of Commerce offers public access to the same information. The tests confirm a correlation of 0.9952 for Colombia and 0.9085 for Chile.

Figure 3.1: Business Registrations in Colombia: Universe v. Sample (2005-2011)

	Universe *Confe-camaras*	Sample *Mint Global*
2005	24368	18895
2006	27065	20902
2007	30415	24823
2008	33351	28591
2009	36559	33547
2010	45293	40626
2011	57320	51016



To exclude the impact of relevant factors that might also influence incorporation decisions, I collected data from the World Bank's World Development Indicators (WDI) to use as covariates, given that they are readably available, uniform, and cover the period of interest. Specifically, I used annual Gross Domestic Product (GDP), labor force, and domestic credit to private sector as a percentage of GDP (domestic credit).

In the WDI database, "labor force comprises people ages 15 and older who supply labor for the production of goods and services during a specified period,"[86]

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[84] General information about Mint Global, at https://www.bvdinfo.com

[85] *See e.g.*, Carsten Gerner-Beuerle et al., *Why do Businesses Incorporate in Other EU Member States? An Empirical Analysis of the Role of Conflict of Laws Rules,* 56 INT'L REV. L. & ECON. 14 (2018); Braun et al., *supra* note 21; Wolf-Georg Ringe, *Corporate Mobility in the European Union – a Flash in the Pan? An Empirical Study on the Success of Lawmaking and Regulatory Competition*, 10 EUR. COMPANY & FIN. L. REV., 230 (2013); and Becht et al., *supra* note 21.

[86] It includes "people who are currently employed and people who are unemployed but seeking work as well as first-time job-seekers. Not everyone who works is included, however. Unpaid workers, family workers, and students are often omitted, and some countries do not count members

while domestic credit generally refers to the "financial resources provided to the private sector by financial corporations."[87]

4.2. Methodology

The methodology employed for the test is inspired by Braun et al.,[88] though it introduces relevant variations in data and design—most notably, a different control group. Using the differences in differences (DiD) technique, the cited study demonstrated that, by eliminating the minimum capital required to register limited liability companies, certain European jurisdictions increased the overall number of registered businesses; that is, a rise in "total entrepreneurial activity."[89]

The DiD technique enables the estimation of the effects of a specific intervention or treatment, by comparing the differences in outcomes before and after the treatment of two groups: one group that is affected by the treatment (treated) and another that is not affected by it (control).[90] I performed one DiD for the Chilean SpA and one for the Colombian SAS. In both, the observation period is 1998-2013, and the treatment is the entry into force of the tested reform.[91] The

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of the armed forces. Labor force size tends to vary during the year as seasonal workers enter and leave." WORLD BANK, *World Development Indicators* (2018), available at http://wdi.worldbank.org

[87] It includes "loans, purchases of nonequity securities, and trade credits and other accounts receivable, that establish a claim for repayment. For some countries these claims include credit to public enterprises. The financial corporations include monetary authorities and deposit money banks, as well as other financial corporations where data are available (including corporations that do not accept transferable deposits but do incur such liabilities as time and savings deposits). Examples of other financial corporations are finance and leasing companies, money lenders, insurance corporations, pension funds, and foreign exchange companies." Id.

[88] Braun et al., *supra* note 21.

[89] Id., at 9. To be sure, their study was motivated by the charter competition caused by the European Court of Justice's *Centros* decision. Still, the model is useful for the purposes of the current study, as it estimates the impact of a domestic legal reform in the entrepreneurial activity of the state in which it was enacted, notwithstanding the competition.

[90] The method is also known as natural experiment or quasi-experiment, to acknowledge that the experiment occurs "when some exogenous event –often a change in government policy– changes the environment in which individuals, families, firms, or cities operate." JEFFREY WOOLDRIDGE, INTRODUCTORY ECONOMETRICS: A MODERN APPROACH, 410 (6TH ED., 2015) (2000)

[91] In 2014, Peru introduced a reform that, despite not creating new entities, was intended to influence patterns of business registration, potentially affecting the results of the test. Specifically, it created the SID (Sistema de Intermediación Digigal), an online platform for the registration of new businesses and documents subjected to official registration. *See* Decreto Supremo N° 007-2014-JUS, and Resolución del Superintendente Nacional de los Registros Públicos N° 234-2014-SUNARP/SN Chile also simplified registration of all business entities by the end of 2013, through Law 20.659 (2013)

treatment groups are all registered business entities per country, with Chile and Colombia as a treated group in each test, and Peru as a control group in both.

Despite the challenges of cross-country analysis, selecting the annual number of registered companies in Peru as a control group appeared as the best option for two main reasons. First, there is no same-jurisdiction alternative. Braun et al. used the annual number of new public corporations per country as a control group, considering the similarities in essential features (i.e., limited liability, mandatory board of directors), tax treatment, and incorporation trends; and that the composition of each group did not change due to the treatment.[92] Although a persuasive decision, the differences between public and private corporations are salient and well documented,[93] as are motivations and the type of businesses that adopt each form,[94] which weakens the credibility and accuracy of the test.[95] But even if one accepts that private and public corporations are sufficiently similar, the

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[92] "[B]oth the private LLC and the public LLC are legal entities separate of their shareholders. They are managed by directors who need not be shareholders. Either company type shields its shareholders against personal liability for the firm's debt ('limited liability'). Perhaps most importantly, both are subject to corporate income tax. While one can find some of these features in certain partnerships as well, their combination is characteristic of corporations (private and public LLCs) and distinguishes them from other legal forms...For all control groups, except Hungary, we find very strong and positive correlations of 0.5 to 0.8, which are also highly statistically significant." Braun et al. *supra* note 21, at 404–406.

[93] *See*, e.g., FRANK EASTERBROOK & DANIEL FISCHEL, *supra* note 26, at 55–56. (highlighting differences that have concrete and crucial implications, despite the annotated similarities between the two forms: "In the close corporations…there is much less separation between management and risk bearing. This has profound implications for the role of limited liability. Because those who supply capital in close corporations typically are also involved in decision-making, limited liability does not reduce monitoring costs. Other benefits of limited liability in public corporations –facilitating efficient risk bearing and monitoring by the capital market– are also absent in close corporations."). *See also* John C. Coffee Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control,* 111 YALE L. J. 1 (2001); Eugene Fama & Michael C. Jensen, *Separation of Ownership and Control,* 26 J. L. & ECON. 301 (1983); and Brian Hindley, *Separation of Ownership and Control in the Modern Corporation*, 13 J. L. & ECON. 185 (1970).

[94] The public corporation is aimed to raise high amounts of capital from large and diverse groups of shareholders, which distinguishes them from all other business forms. Paul Rose and Steven Davidoff Solomon recently presented econometrics evidence of the declining number of small public corporations in the US, which they attribute "to their inability to survive and grow." From their analysis it is conspicuous that, even after specific reforms tailored to expand the market of public corporations, only large businesses are able to survive and thrive as public corporations. Paul Rose & Steven Davidoff Solomon. *Where Have All the IPOs Gone: The Hard Life of the Small IPO*, 6 HARV. BUS. L. REV. 83, 87 (2016)

[95] For an overview of the implications of inconsistencies between treatment and control groups, and potential solutions when cross-country comparisons are unfeasible, *see* Coady Wing et al., *Designing Difference in Difference Studies: Best Practices for Public Health Policy Research,* 39 ANN. REV. OF PUB. HEALTH 453 (2018); Sephen Donald & Kevin Lang, *Inference with Difference-in-Differences and Other Panel Data,* 89(2) REV. ECON. & STAT. 221 (2007); and Alberto Abadie, *Semiparametric Difference-in-Differences Estimators,* 72 REV. ECON. STUD. 1 (2005)

number of annual incorporations of each type of corporate form follow different trends in both countries,[96] further disregarding a potential same-jurisdiction alternative.

The second and most important reason justifying the control group selection is that Peru is similar to Chile and Colombia in aspects that are crucial for the test. First, it shares the geographical, historical, linguistic, and cultural ties that characterize Latin America as a region. Second, it belongs to the same legal family[97] and has endured comparable development of business and corporate law.[98] Third, the three countries experienced similar GDP and population growth patterns for over 20 years.[99] Furthermore, SMEs participation in employment is analogous in all three economies,[100] as are exports rates and composition,[101] and foreign direct investment (FDI) contribution to economic growth.[102] They also face similar

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[96] Absent policies like the ones investigated here or deep declines in economic growth, the number of new private corporations tends to grow sustainably. *See* Leora Klapper et al., *Entrepreneurship Around the World –Before, During, and After the Crisis* (World Bank Group and International Finance Corporation – Smart Lessons No. 21467, 2014). In contrast, incorporations of public corporations in Chile and Colombia do not increase annually. In fact, the data of the Colombian stock exchanges reveals that, over the last two decades, there has been 10 non-consecutive years without new public corporations. Moreover, the years with more than two are exceptional and do not follow a trend. Still, I performed a test with data from Mint Global, which corroborates the lack of correlation in the case of Colombia (0.06). Although the results were less conclusive for Chile (0.4), the correlation between registration of private corporations in Chile and Peru before the treatment is still higher (0.95) as detailed below. Data on Chilean public corporations is available at http://www.cmfchile.cl. For Colombia, *see* www.bvc.com.

[97] *See* Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998) (classifying it as French civil law). *See also* Rafael La Porta et al., *The Economic Consequences of Legal Origins,* 46 J. ECON. LIT. 285 (2008).

[98] Eder, *supra* note 60.

[99] For almost three decades, all three economies have experienced an average annual GDP growth rates of 2-5%, and an average annual population growth of 1-1.2%%; according to the World Bank's WDI and Data Population Division, respectively. Both databases are available at http://data.worldbank.com

[100] The most recent comprehensive study of these economies found that "SMEs account for approximately 99% of businesses and 67% of employment in PA countries." *See* OECD, HOW TO FOSTER THE INTERNATIONALISATION OF SMES THROUGH THE PACIFIC ALLIANCE INTEGRATION PROCESS, 12 (2015).

[101] According to the same study, "81%, 78%, and 84% of exports [consist] of primary commodities for Chile, Colombia and Peru, respectively." In all three of them, 70% of exports are accounted by large multinational enterprises. Id., at 7 and 14.

[102] Inflows of FDI have fluctuated between 2-10% of annual GDP in all three countries. Although the rates are historically higher for Chile (often above 10%), the trend in recent years is almost equivalent. Interestingly, in 2017, which is the latest reported data, Chile had the lowest participation of FDI in GDP (2.3%), compared to Colombia (4.5%) and Peru (3.2%), according to the World Bank's WDI data, available at http://data.worldbank.com

challenges in reducing informality and promoting entrepreneurship,[103] share an economic development strategy grounded in market liberalization,[104] and rely on a best-practices approach to institutional reform.[105] Remarkably, along with Mexico, the three countries are the founding members of both the Pacific Alliance, a regional economic bloc formed in 2011,[106] and MILA (Mercado Integrado Latinoamericano or Latin-American Integrated Market), which integrates the stock exchanges of the four economies.[107] Notwithstanding all these strong similarities, I included the covariates mentioned above to isolate country-specific factors that might influence changes in incorporation rates.

In addition to a careful selection of the groups and data, the DiD estimation of causal effects requires proof of two fundamental assumptions.[108] First, the treatment must be randomly assigned only to the treated group, leaving the control group unaffected by the treatment. Second, the behavior of the treatment and control groups must correlate before the treatment (parallel trend assumption). For this test, I found that the procedure and the data for business registration are

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[103] *See* World Bank Enterprise Survey, *supra* note 45; Tor Jansson & Geoffrey Chalmers, *supra* note 46; and Cathy Rakowski, *supra* note 47.

[104] The three countries are among Latin America's most liberal economies, as evidenced by their early adherence to the General Agreement on Tariffs and Trade (GATT), and their continuous membership in the World Trade Organization (WTO). Chile became a member of the GATT in 1949, Colombia in 1981, and Peru in 1951. Complementary information is available at the WTO website: https://www.wto.org For a critical overview of the liberalization process, *see* Joshua Aizenman, *Financial Liberalizations in Latin America in the 1990s: A reassessment*, 28(7) WORLD ECON., 959 (2005). For commentary and empirical evidence on the role of FDI in the liberalization process, *see* Alvaro Pereira, *Legal Stability Contracts in Colombia: An Appropriate Incentive for Investments? Historical Causes and Impact Analysis of Law 963 to 2005*, 12 RICH. J. GLOBAL L. & BUS. 237 (2013), and Glen Biglaiser & Karl DeRouen, *Economic Reforms and Inflows of Foreign Direct Investment in Latin America,* 41 LAT. AM. RES. REV. 51 (2006). For an analysis of the development of bond markets in the region, *see* Eduardo Borensztein et al., *Building Bond Markets in Latin America in* BOND MARKETS IN LATIN AMERICA: ON THE VERGE OF A BIG BANG, 1–28 (Eduardo Borensztein et al. eds., 2008)

[105] While Chile and Colombia (along with Mexico) are the only current OECD members in Latin America, Peru is in the process of becoming the fourth and "is amongst the first countries to engage with the OECD through an OECD Country Programme," which supports a best-practice approach to institutional reform. Complete information on Peru's ongoing relation with the OECD is available at https://www.oecd.org/latin-america/countries/peru/

[106] Since the creation of the Pacific Alliance, its member states have adopted measures to ensure the free movement of goods, services, capital, and people within their borders. For complementary analysis of the process and prospects, *see* JASON MARCZAK & SAMUEL GEORGE, PACIFIC ALLIANCE 2.0 (2016), and Jaime García, *Alianza del Pacífico, ¿Hacia dónde vamos?*, 31 AGENDA INTERNACIONAL 43 (2013). Updated information at https://alianzapacifico.net/

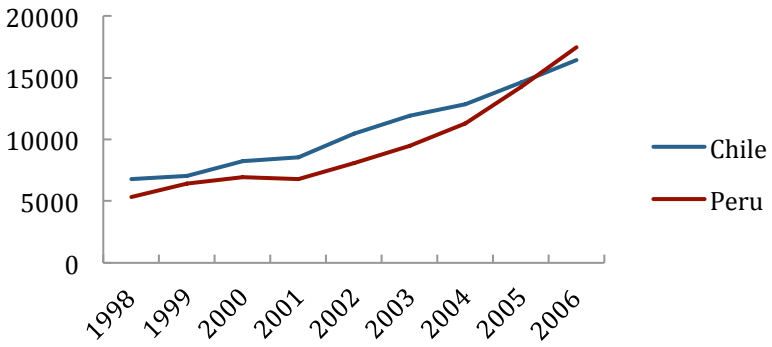
[107] MILA is also enhancing harmonization in accounting, tax, and securities regulation. *See* DIEGO AUVERT & GUILLERMO PERRY, FINANCIAL INTEGRATION IN THE PACIFIC ALLIANCE (2016)

[108] On the DiD Method *see* Michael Lechner, *The Estimation of Causal Effects by Difference-in-Difference Methods,* 4 FOUND. & TRENDS ECON. 165 (2011), and Alberto Abadie, *supra* note 89.

equivalent for Peru and the treated groups[109] to "make it appear *as if* the treatment is randomly assigned"[110] to one group and not to the other, as expected in a quasi-experiment that is not exposed to the internal validity threats of actual experiments. My research of the main reforms in all selected countries also reveals that Peru did not implement any related corporate law reform in the observation period,[111] completing the proof of the first assumption. To test the parallel trend assumption, I conducted a correlation assessment. Between 1998-2006, the data for Colombia and Peru shows a positive correlation of 0.977, and between Chile and Peru of 0.953.

Figure 3.2: Pre-Treatment Trend Between Chile and Peru *

	Chile	Peru
1998	6770	5312
1999	7061	6446
2000	8252	6944
2001	8570	6761
2002	10448	8079
2003	11924	9476
2004	12875	11305
2005	14593	14256
2006	16406	17453



* *Registration of all business entities per year. Data from Mint Global (2019)*

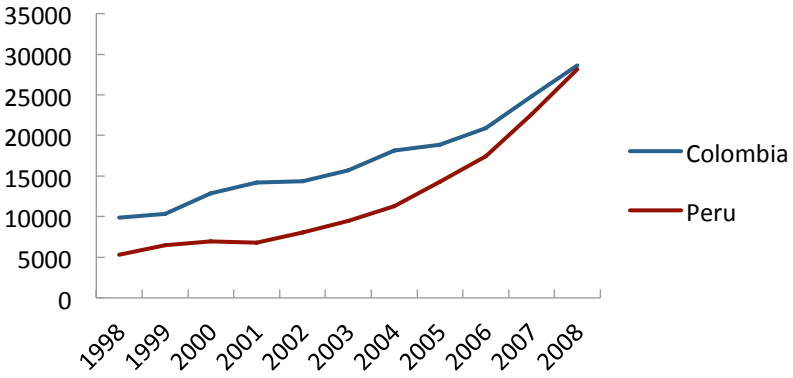
[109] In the three jurisdictions, the articles of incorporation and bylaws must contain the same information. They also have to be written in a public deed and registered in the commercial registry. Chilean law requires an additional publication in an official gazette. Relevant statutory provisions are Chilean Law 18.046 (1981), articles 3-5; Colombian Commerce Code, Decree 410 (1971), articles 110-111; and Peruvian, General Law of Corporations, Law 26887 (1997), article 5.

[110] JAMES STOCK, & MARK WATSON, INTRODUCTION TO ECONOMETRICS, 539 (3rd Global Ed., 2015) (2002).

[111] Its last major corporate law reform was, in fact, in 1997, when the current corporate statute was enacted. For a detailed historical account, *see* Oswaldo Hundskopf, *Reseña Histórica de la Ley General de Sociedades No. 26887 in* LEY GENERAL DE SOCIEDADES. ESTUDIOS Y COMENTARIOS A VEINTE AÑOS DE SU VIGENCIA, 11–19 (María Elena Guerra-Cerrón ed. 2018)

Figure 3.3: Pre-Treatment Trend Between Colombia and Peru **

	Col	Peru
1998	9880	5312
1999	10346	6446
2000	12862	6944
2001	14220	6761
2002	14361	8079
2003	15665	9476
2004	18175	11305
2005	18895	14256
2006	20902	17453



** *Registration of all business entities per year. Data from Mint Global (2019)*

5. Empirical Analysis

5.1. Descriptive Statistics

Table 3.3 presents the results of a simple comparison between the average yearly incorporations in Chile and Colombia, before and after the reform, for the period 1998-2013, the one used for the DiD. In both cases, they reflect significant increases that motivate further inquiries on the effect of the reforms. Table 4 contains the same comparison but for a narrower period (two years before and two after), which significantly reduces the changes in average annual incorporations: in Chile, the decrease is from 152% to 20%, and in Colombia from 64% to 39%.

Table 3.3: Average Yearly Incorporations Before and After Reforms (1998-2013)

Country	Reform	Reform date (in force)	Pre reform	Post reform	Percentage change
Chile	SpA	May 17, 2007 (June 5, 2007)	11,426.9	28,790.7	+152
Colombia	SAS	December 8, 2008 (Id.)	17,156.4	48,092.8	+64

Table 3.4: Average Yearly Incorporations, Two Years Before and Two Years After Reforms

Country	Reform	Reform date (in force)	Pre reform	Post reform	Percentage change
Chile	SpA	May 17, 2007 (June 5, 2007)	16,888	20,220	+20
Colombia	SAS	December 8, 2008 (Id.)	17,156.4	51,360.3	+39

In normal circumstances, business registrations tend to increase,[112] which might explain why the changes are more pronounced when considering longer periods. To better understand these patterns, I conducted separate tests, measuring the increases on an annual basis. As reported in Table 5, reforms might have accelerated the natural increase in annual registrations. Chile experienced a 15% annual increase in the number of newly registered businesses in the period of interest. Notably, the growth rate was slightly lower before the reform (11%) and higher after (17%). Changes appear to be less significant in Colombia: 12% annual increase before the reform and 15% after.

Table 3.5: Annual Growth in Incorporation—Percentage Changes

Country	Average 1998-2013	Pre reform	Post reform
Chile	+15	+11	+17
Colombia	+13	+12	+15

These results suggest that the reforms might have influenced an increase in the number of registered businesses or, at least, accelerated the already ascending rate of annual registrations. In that sense, they further motivate the DiD analysis, which isolates the effects.

[112] There is evidence of this intuitive relation between economic growth and new businesses. *See* Leora Klapper *supra* note 90, at 2. (finding that the main factors influencing declines in business registrations are "…lack of credit, uncertainty about the future, and lower aggregate demand…")

5.2. Did the SpA Promote Entrepreneurship in Chile?

To test the null hypothesis (that the reforms had no effect in overall firm registration), I employ the following DiD regression model:

$$Yit = \beta0 + \beta1*Ref + \beta2*Treat + \beta3*Ref*Treat + \beta4*[Covariates]+\varepsilon$$

Yit is the dependent variable, representing the number of business registrations per year, in 10.000, from 1 January 1998 to 31 December 2013. *Ref* is a dummy variable distinguishing whether the registration was affected by the reform as follows:

Ref = 0: if i is a Peruvian registered business

= 1: if i is a Chilean registered business

Treat is another dummy variable that distinguishes the period before and after the reform. The reform was in force in June of 2007 but, since the data captures yearly incorporations only and the law does not operate retroactively, I accounted 2008 as the first year. Because the law was both extensive and complex, it also seems more reasonable to expect entrepreneurs and lawyers to spend time studying it rather than using the SpA immediately.

Treat = 0: if *t* is 1998-2007

= 1: if *t* is 2008-2013

*Ref*Treat* is the DiD estimator, the coefficient of interest. *Covariates* include the control variables as follow: in Model 2, GDP; in Model 3, GDP and Labor Force; Model 4, GDP and domestic credit. Model 1 has no covariates and Model 5 includes all.

Table 3.6: Effects of SpA in Chile

	Model 1	Model 2	Model 3	Model 4	Model 5
_cons	-445.28***	-158.82*	7.459	-157.4328	592.16**
	(69.294)	(91.948)	(150.007)	(93.855)	(219.15)
time	0.222***	0.793*	-0.005	0.078	-0.303**
	(0.034)	(0.460)	(0.075)	(0.469)	(0.111)
treat	0.055	-0.437*	1.126	-0.596	2.784**
	(0.218)	(0.216)	(1.141)	(0.717)	(1.096)
Treat*Ref	-1.414***	-1.906***	-1.515***	-1.978***	-1.806***
	(0.357)	(0.314)	(0.418)	(0.443)	(0.365)
gdp		1.43***	1.55***	1.41***	1.48***
		(3.64)	(3.69)	(3.83)	(3.14)
laborforce			2.43		1.05***
			(1.75)		(2.89)
domcred				0.003*	0.075**
				(0.014)	(0.022)
R2	0.9031	0.9392	0.9435	0.9393	0.9610
Adj. R2	0.8887	0.9275	0.9300	0.9247	0.9496
F for change in R	62.91	80.28	69.61	64.47	84.44
Num. obs.	32	32	32	32	32

NOTE: _cons is the baseline average. Time is 0 in years 1998-2008, and 1 in years 2009-2013. Treat is 0 for Peru, 1 for Chile. Standard errors in parenthesis.
*** p<0.01, **p<0.05, * p<0.1.

The estimates corroborate that the introduction of the SpA affected overall business registration in Chile. The interaction term is negative and statistically significant in all four models. These results are relevant for two reasons. The first is that the reform did not meaningfully reduce registration requirements. It only made it optional to use a private document instead of a public deed, without modifying other costly and time-consuming procedures. Hence, with regards to the regulation of entry, it would only support the premise that the public deed is a procedural burden to business registration.

A second consideration is the role that single ownership and equity finance might have played in the results. During the first five years following the reform, less than 10% of the businesses adopted the SpA form,[113] and only a decade after does it appear to capture over half of the market. Nevertheless, as noted in Table 7, the

[113] Maria F. Vásquez Palma, *Sobre la Limitación de Responsabilidad en el Derecho de Sociedades y su Posible Extensión en el Contexto de la Modernización,* 27 REVISTA DE DERECHO (VALDIVIA) 105 (2014)

introduction of the SpA correlates with a significant increase in the number of registered corporations as a percentage of overall registered businesses and a modest increase in a partnership-type form allowing single ownership (*EIRL – Empresa Individual de Responsabilidad Limitada*). Interestingly, the traditional alternative to the corporate form (*SRL - Sociedad de Responsabilidad Limitada*) that does not divide its capital into shares and cannot have a single owner, is the only relevant entity that lost participation in the Chilean market for business entities. This suggests that equity finance and single ownership were relevant for Chilean entrepreneurs and likely drove the identified increase in overall firm registration.

Table 3.7: Business Registrations in Chile (2007-2009) [114]

	Non-equity entities		Equity entities	
	SRL	EIRL	Corporation (SA)	SpA
2007	59,5%	21,1%	18,9%	0,48%
2008	45,4%	24,3%	26,2%	4,09%
2009	44,2%	24,3%	25,5%	5,96%

A review of the legislative history and the content of the law further supports the latter conclusion. The SpA was introduced through an extensive piece of legislation aimed at stimulating the venture capital (VC) industry in the country and, more broadly, small firms' access to finance.[115] Although key corporate law innovations (simplified incorporation procedures, single ownership, and freedom to regulate shares) are exclusive to the new corporate entity, the law included additional incentives to equity investments that might have contributed to increasing awareness on its benefits. For instance, it created a tax incentive for businesses with VC investments[116] and enhanced the sources of finance for VC funds.[117] The law also improved the financial capacity of registered firms. It created

[114] Id. Numbers reflect percentages of overall business registration. Entities unrelated to the present analysis are excluded.

[115] The law was so comprehensive and technical, that it was debated and negotiated for four years. In June 2003, the (then) President, Ricardo Lagos presented the project to Congress, stating that the stimulating the venture capital industry was an economic priority that justified changes to the regulation of banks, corporate insolvency, investment funds, and capital markets, among others. His complete speech, as well as the debates that followed, are available at Chilean Congress Library: www.bcn.cl

[116] Law 20.190 (2007) Art. 1

[117] For instance, by allowing VCs to raise funds from pension funds or banks. *See* Id. articles 3 and 4.

a new system for the registration of mobile assets as collaterals,[118] and reforms to bankruptcy rules authorizing agreements among creditors of all types of business entities, including those with a single owner.[119] It appears that the law's emphasis on improving the financial capabilities of small and expanding firms –in particular, the benefits of financing through equity– influenced many entrepreneurs' decision to incorporate.

5.3. Did the SAS Promote Entrepreneurship in Colombia?

To estimate the effects of the SAS reform in Colombia, I employed the same model but with the following changes in the dummy variables:

Ref = 0: if i is a Peruvian registered business

= 1: if i is a Colombian registered business

Treat = 0: if *t* is 1998-2008

= 1: if *t* is 2009-2013

In the case of Colombia, only Models 2 (GDP) and 4 (GDP and domestic credit) find a significant effect of the reform in overall business registration. Model 1, which did not incorporate covariates, also captures an impact but not a substantial one. Models 3 and 5, controlling for "labor force," fail to capture any effect. Therefore, the identified increases in incorporations cannot conclusively be attributed to the law.

[118] Id. Art. 28. For doctrinal analysis *see* Alejandro Guzmán, *El Llamado Contrato de Prenda sin Desplazamiento*, 13 REVISTA CHILENA DE DERECHO PRIVADO, 161 (2009)
[119] Law 20.190 (2007) Art. 13

Table 3.8: Effects of SAS in Colombia

	Model 1	Model 2	Model 3	Model 4	Model 5
_cons	-467.667***	-190.429***	-1131***	-233.212**	-1151.76***
	(63.806)	(80.540)	(152.05)	(105.53)	(157.34)
time	0.234***	0.095***	0.570 ***	0.116**	0.581***
	(0.234)	(0.040)	(0.768)	(0.052)	(0.794)
treat	0.471**	-0.258	4.657***	-0.227	4.646***
	(0.210)	(0.233)	(0.764)	(0.241)	(0.774)
Treat*Ref	-0.184	-1.290***	0.178	-1.221***	0.212
	(0.376)	(0.386)	(0.327)	(0.405)	(0.336)
gdp		1.19***	1.55***	9.75**	1.42***
		(2.73)	(1.78)	(4.35)	(2.78)
laborforce			-9.43***		-9.37***
			(1.44)		(1.46)
domcred				0.014	0.009
				(0.023)	(0.014)
R2	0.9277	0.9582	0.9846	0.9589	0.9849
Adjusted R2	0.9170	0.9502	0.9809	0.9490	0.9805
F for change in R	86.6	119.28	266.62	97.20	223.14
Num. obs.	32	32	32	32	32

NOTE:_cons is the baseline average. Time is 0 in years 1998-2008, and 1 in years 2009-2013. Treat is 0 for Peru, 1 for Colombia. Standard errors in parenthesis.
*** p<0.01, **p<0.05, * p<0.1

Two situations could plausibly explain the results. The first is unemployment. In the months following the creation of the SAS, unemployment reached its highest point in three years,[120] and remained high for a prolonged period, due to the global financial crisis and the drop in oil prices, among others.[121] The significance of the increases in unemployment and the sustained trend that followed[122] might have compelled necessity entrepreneurs to incorporate. In Bogotá, which accounts for one-third of Colombia's GDP, there is evidence supporting this claim. According to a

[120] Unemployment reached 14.25% in January 2009, and remained comparatively higher than previous years, when it fluctuated between 10-12%, (with a few jumps to 13% in the first months of the year), according to data from National Statistics Administrative Department (DANE), available at http://www.banrep.gov.co/es/tasas-empleo-y-desempleo

[121] *See* Ramon J. Mesa et al., *Crisis Externa y Desaceleración de la Economía Colombiana en 2008-2009: Coyuntura y Perspectivas,* 12 PERFIL DE COYUNTURA ECONÓMICA 31(2008)

[122] One of the leading economic magazines sentenced: "Unemployment in Colombia ended 2009 as it began: increasing." PORTAFOLIO, *Desempleo en Colombia Terminó el 2009 Como lo Comenzó: Aumentando*, PORTAFOLIO, (Jan. 28 2010, 5:00 AM), https://www.portafolio.co/economia/finanzas/desempleo-colombia-termino-2009-comenzo-aumentando-190606 (last visited Jun. 15, 2019)

study of new business registration conducted by Bogotá's Chamber of Commerce, 85% of SAS were micro and 11% small in the reform's first year.[123]

A second situation that might have driven surges in business registration is an unprecedented rise in the number of Venezuelan migrants fleeing from a political and legal environment hostile to businesses.[124] An illustrative description of this anomaly came from one of those migrants, who stated: "the best president Colombia has had is [Venezuelan president] Hugo Chavez. Thanks to him, most Venezuelans who are educated and have money to invest are here today."[125] Although the migrant population has diversified in recent years, that statement captured a trend that roughly extended from 2005 to 2013.[126] In 2008, the year the SAS was introduced, Colombia received one of the largest groups of Venezuelan migrants within that period,[127] a situation that potentially contributed to the increase in firm registration. Notably, Venezuelan and Canadian investors founded the largest oil company in the country, Pacific Rubiales, in 2008.

Notwithstanding the above, the SAS seized the Colombian market for business entities much faster than the SpA in Chile. As noted in Figure 3.4, it became the preferred entity in just a few months. Traditional accounts evaluated that tendency

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123 *See* CÁMARA DE COMERCIO DE BOGOTÁ, 'EL PERFIL ECONÓMICO Y JURÍDICO DE LAS SAS EN SU PRIMER AÑO (2010)

124 Hugo Chávez, President of Venezuela between 1999 and 2013, became a global champion of state-controlled economies in the beginning of the twenty first century. His anti-market economic policies, which included massive expropriations and strict exchange controls, deterred private investments and entrepreneurial activity. An overview of the main economic policies and their impact *see* Mark Weisbrot & Luis Sandoval, *The Venezuelan Economy in the Chávez Years*, (Center for Economic and Policy Research, 2007). *See also* Gustavo Flores-Macías, *Statist vs. Pro-Market: Explaining Leftist Governments' Economic Policies in Latin America,* 42(4) COMP. POL., 413 (2010) (identifying crucial differences in the economic programs of Chávez and other Latin American leaders associated to him. These differences help elucidate why only Venezuela generated a migratory crisis in the region.)

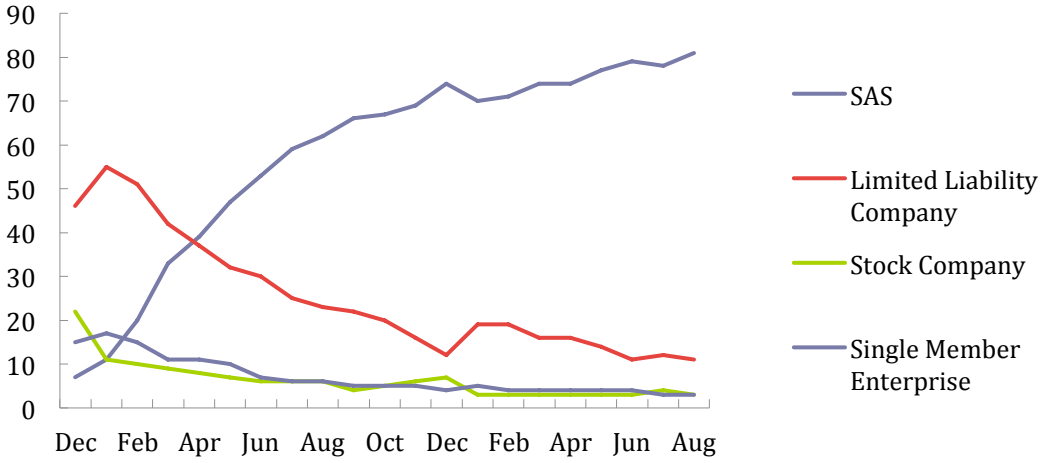
125 SEMANA, Llegaron los Venezolanos, SEMANA (Ap. 6 2011 12:00:00 AM), https://www.semana.com/nacion/articulo/ llegaron-venezolanos/240865-3 (last visited Jun. 15, 2019)

126 *See* Carlos Rodriguez, *Colombia es el Escampadero de Empresas Venezolanas*, La República (Ap. 1 2017), https://www.larepublica.co/globoeconomia/colombia-es-el-escampadero-de-empresas-venezolanas-2491356 (last visited Jun. 15, 2019) (providing detailed information of Venezuelan businesses that moved to Colombian in that period and their impact in the economy.) *See also* DINERO, *Millonarios y Exitosos: la Otra Cara de la Migración Venezolana a Colombia*, DINERO (Feb. 1 2018, 10:36 AM), https://www.dinero.com/internacional/articulo/la-otra-cara-de-la-diaspora-de-venezuela-que-disfruta-del-sueno-colombiano/253759 (last visited Jun. 15, 2019) (providing similar information but with a focus on portfolio investments from Venezuelans in Colombia).

127 Id.

as demonstrative evidence of its impact in overall firm registration.[128] However, since the results of the DiD estimation do not support such an inference, a more precise interpretation is that the SAS was favored by those who had already decided to incorporate. The previously cited study of incorporations in Bogotá revealed that, in the reform's first year, 22% of registered SAS were established businesses that transformed. Of those firms, 60% had the LLC form,[129] which, as discussed above, did not allow for single ownership or equity investments. These features are therefore relevant to interpret the SAS' demonstrative success in changing the preferences of entrepreneurs and legal advisors.

Figure 3.4: Business Registrations in Colombia, 2008-2010[130]



The structure of the law and its minimum registration requirements also shaped a positive perception of the SAS. Unlike the SpA, which was part of a broader economic reform, Colombian Law 1258 (2008) was exclusively dedicated to the SAS, detailing all its features in a statute with a comparatively simpler language that made it more accessible for both lawyers and entrepreneurs. Its first articles made explicit reference to limited liability, single ownership, and to the possibility of

[128] *See e.g.*, Francisco Reyes, *supra* note 76, at 402 (affirming that the number of incorporations "has increased exponentially since the enactment of Law 1258 on December 5 of 2008.")

[129] The report also noted that 20% where private corporations (requiring a minimum of 5 founders) and 13% a weaker version of single owner entity with no equity. *See* CÁMARA DE COMERCIO DE BOGOTÁ, *supra* note 116.

[130] Francisco Reyes, *supra* note 60. "Stock Company" refers to the Corporation, and "Single Member Enterprise" to the EIRL.

incorporating through the registration of a private document instead of a public deed. In its first year anniversary, the media highlighted these innovations and the flexibility to regulate shares as drivers of the surge in SAS incorporations.[131]

6. Implications

6.1. Corporate Law as a Tool to Promote Entrepreneurship

The evidence presented above confirms that, beyond the regulation of entry, corporate law can meaningfully contribute to promoting entrepreneurship through the creation of simplified corporate forms with single owners and enhanced access to equity finance. Just as the overall economic environment, the legal architecture matters.

Chile introduced its SpA as part of a broader reformative agenda aimed at improving new and growing businesses' access to finance, which appears crucial to boost the interest in entrepreneurship. Law 20.190 (2007) significantly improved traditional financing possibilities (e.g., expanded the types of assets that can guarantee credits, simplified their registration, authorized agreements between creditors), and introduced incentives to equity finance, such as tax benefits for firms with VC investments. This strategy successfully contributed to promoting the advantages of incorporating and, most importantly, the benefits provided by entities with capital divided into shares. While most new businesses did not adopt the SpA form immediately, the tests captured a significant increase in the number of newly registered businesses per year and most of them where corporate-type entities.

Colombian Law 1258 (2008) was exclusively dedicated to regulating the SAS. Notwithstanding the legal innovations it introduced to facilitate equity finance, promoters emphasized the advantages of single ownership and a reduction in incorporation and operation costs. These features might explain why it quickly captured the market for business registrations, albeit not offering tax incentives equivalent to the Chilean reform or to the one popularized the LLC in the United States. In that sense, despite not promoting entrepreneurship, the SAS experience

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131 *See* EL ESPECTADOR, *Hasta Octubre se Han Creado 10.288 Sociedades por Acciones Simplificadas,* EL ESPECTADOR (Nov. 11 2009, 3:58 PM), https://www.elespectador.com/economia/articulo171633-hasta-octubre-se-han-creado-10288-sociedades-acciones-simplificadas (last visited Jun. 15, 2019)

demonstrates that entrepreneurs evaluate and react to corporate law innovations, beyond the regulation of entry.

6.2. The Pacific Alliance

The DiD results could also have concrete implications for the Pacific Alliance. Given its foundational purpose of accelerating economic growth and development through common economic policies, the results of the test can contribute to two current priorities for the Alliance: fostering entrepreneurship and promoting capital market development.

Entrepreneurship is at the core of the economic agenda of the Pacific Alliance, which could facilitate sound corporate law reform, an elusive ambition in the Alliance member states. Entrepreneurship was listed as a priority in the Alliance's 2030 commitments,[132] guiding the ongoing development of common policies for SMEs, innovation, and education, among others.[133] However, corporate law remains within the jurisdictional borders of the Alliance member states, which have individually and uncoordinatedly implemented reforms. Both Mexico[134] and Peru[135] have failed to properly incentivize entrepreneurship through simplified corporate forms, although the former successfully introduced an entity for

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[132] The agenda, entitled "Visión Estratégica de la Alianza del Pacífico al año 2030," was signed by the heads of state of member states in their XVIII meeting, held on July 24 2018 at Puerto Vallarta, Mexico. The document is available at https://alianzapacifico.net

[133] To design those policies, the Alliance established specialized working groups responsible for the creation of an SMEs observatory, a common seed fund, networks of innovation agencies and business accelerators, and an intra-Alliance scholarship program, among other concrete complementary programs to foster entrepreneurship. *See* https://alianzapacifico.net/

[134] Mexico introduced its own SAS in a March 14 2016 amendment to the General Law of Corporations, but relevant limitations deprive it from the benefits offered by its Chilean and Colombian counterparts. First, only natural persons can be shareholders and must not have control of another business entity. Second, SAS have an annual revenue cap of five million Mexican pesos (approximately, $250.000USD). If exceeded, shareholders must transform into other legal form or lose the limitation of liability. Third, the articles of incorporation must be elaborated through an electronic platform provided by the Secretary of Economy that prevents additional agreements. Fourth and most importantly, shareholders might be liable for criminal activities committed by the corporation, even if they had no involvement in said activities. The Mexican SAS, in this sense, does not grant access to limited liability as the LLC. *See* Mexican General Law of Mercantile Companies, article 262. For an analysis, *see* SOYLA LEÓN TOVAR, SAS, SOCIEDAD POR ACCIONES SIMPLIFICADAS: ESTUDIO TEÓRICO PÁRACTIVO (2018)

[135] On September 2018, Peru created a simplified corporate form. Despite being inspired by the Colombian experience, the new legal entity does not allow ingle ownership or the regulation of shares through by laws, but rather focuses on the regulation of entry. *See* Presidential Decree 1409 (2018), authorized by Ley 30823 (2018), available at http://www.leyes.congreso.gob.pe/

"scale-ups"–or fast-growing companies seeking to raise capital to expand.[136] In this context, the reported effects on the impact of the SpA and the SAS should be useful to develop minimum common standards in corporate law for entrepreneurs. While single ownership and freedom to regulate shares are common features, the SpA experience shows that complementary incentives for finance further contribute to fostering entrepreneurship. The SAS, in turn, evidences that a separate statute with a simpler language can more effectively and quickly direct entrepreneurs toward a legal form that is more appropriate for equity finance.

The Pacific Alliance is also set up to strengthen capital market growth jointly, as evidenced by the integration of its members' stock exchanges under MILA *(Mercado Integrado Latinoamericano – Integrated Stock Exchanges*) and continued harmonization efforts.[137] However, as detailed above, informality has constrained entrepreneurship, productivity, competitiveness, and firm growth in greater Latin America, which partially explains the underperformance of stock markets. The reported findings demonstrate that simplified corporate forms can increase the number of registered businesses, and incentivize equity investments, both indispensable to expand stock markets in the Alliance.

7. Conclusion

Most contemporary corporate law reforms focus on reducing business registration requirements to promote entrepreneurship and, ultimately, accelerate economic development. As a result, the regulation of entry is functionally equivalent in most economies and continually transiting towards convergence. Even so, rates of firm registration continue to differ and do not appear to respond uniformly to policies reducing procedures, time, and costs to register a business.

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[136] Known as SAPI (stands for "Sociedad Anónima Promotora de Inversión") and created through a capital market reform, this special corporate form allows bylaws regulation of shares, board, and management structure. Notwithstanding, it maintained the traditional corporation's costs of entry and governance formalities. *See* Mexican Law of Capital Markets, articles 12-18. For an analysis, *see* Rodrigo Dominguez & Carlos Treistman, *The Future Of Private Equity In Mexico,* 6 LATIN LAWYER (May 10, 2007), https://latinlawyer.com/article/1085800/the-future-of-private-equity-in-mexico (last visited Jun. 15, 2019). The term "scale-up" was introduced by Gilles Duruflé et al., *From Start-up to Scale-up: Examining Public Policies for the Financing of High-Growth Ventures* (Bruegel Working Paper No. 4, 2017)

[137] *See* AUVERT & GUILLERMO PERRY, *supra* note 101.

The results of the DiD tests reported in this paper indicate that simplified corporate forms, characterized by single ownership and freely regulated shares, are appropriate incentives for entrepreneurship. Chilean SpA, introduced through a broader reform enhancing the financial capabilities of growing businesses, effectively increased overall firm formation. By dedicating a separate statute exclusively to its new corporate form (SAS), the Colombian legislator was able to direct entrepreneurs toward a legal entity that is more appropriate for equity investments. Overall, the tests demonstrate that corporate law can meaningfully influence entrepreneurship beyond the regulation of entry.

Chapter Four

Economic Freedom in the Pacific Alliance's Corporate Law

1. Introduction

Non-listed firms are growing beyond traditional frontiers at an accelerated pace. In virtually all economies, private corporations are disrupting and even creating new markets, consolidating large customer bases and financial resources, as only public companies were capable not too long ago.[1] Although markets have gradually adjusted to the expanding social and economic significance of private firms, the study of the laws that determine their governance structures and access to external finance remains under scrutinized, particularly in comparative perspective.

The literature in business organizational forms, for example, has persistently neglected the relevance of the corporation and corporate law for private businesses. These firms are characterized as local, family-owned or otherwise comprised by a limited number of participants, with some holding the dual condition of shareholders and managers.[2] To control for opportunism—it is submitted—, shareholders establish partnership-type governance arrangements, such as equal-share rules or rules constraining management's powers (e.g., conditioning their decisions to shareholder approval); hence, in practice, private businesses contract out of corporate law, rendering it irrelevant.[3]

Two recent regulatory developments in business organizations have further diminished the study of corporate law as a determinant of private firms' governance and financing potential. On the one hand, the proliferation of hybrid business forms,

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[1] Notable examples include *Airbnb* in the United States, *Go-Jek* in Indonesia, *Rappi* in Colombia and *OPay* in Nigeria. All of them have valuations over one billion dollars, interact with millions of customers in different countries and provide thousands of direct and indirect jobs. For an analysis, *see* section 1.

[2] Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986)

[3] *See* section 2.2.

which generated an on-going discussion among business law scholars on how the law—not only corporate law—could better support the needs of specific firms, such as professional services providers.[4] On the other hand, an outburst of reforms reducing registration requirements for businesses—not only corporations—that spawned a series of empirical studies discussing the impact of those requirements on entrepreneurship.[5]

Concomitantly, a growing comparative corporate governance scholarship enriched the understanding of the corporation and corporate behavior with novel and interdisciplinary analysis. However, by focusing on public corporations, it has provided discrete insights on how corporate laws influence governance and financial arrangements in non-listed firms.[6]

The literature on venture finance, which studies the funding of private corporations, also discards corporate law as a relevant determinant of venture deals, as those are considered to be in the domain of contract law.[7] Shockingly, studies that do explore the influence of laws and institutions in the financing of startup companies pervasively rely on indexes and rankings of legal systems that are either based on the regulation of public corporations or use "legal origins" classifications that have been disproven by legal scholarship.[8]

As a result, corporate law's influence in private firms' governance arrangements and access to external finance has been underexamined. Such an examination is necessary for two reasons. First, virtually all fast-growing private firms adopt the corporate form and are therefore subject to the corporate laws of the country in which they are incorporated.[9] Second, differences between legal systems matter for both entrepreneurs and investors. There is evidence that investors and entrepreneurs experience difficulties in structuring governance

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[4] For an overview, *see* Joseph McCahery, *Governance in Partnership and Close Corporation Law in Europe and the United States*, in THE GOVERNANCE OF CLOSE CORPORATIONS AND PARTNERSHIPS: US AND EUROPEAN PERSPECTIVES 1-19 (Joseph McCahery & Erik M. Vermeulen eds., 2004)

[5] *See*, e.g., Leora Klapper et al., *Business Environment and Firm Entry: Evidence From International Data* (World Bank Policy Research Working Paper No. 3232, 2004); and Simeon Djankov et al., *The Regulation of Entry*, 117 Q. J. ECON. 1 (2002)

[6] Holger Fleischer, *Comparative Corporate Governance in Closely Held Corporations*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE, 680-720 (Jeffrey N. Gordon and Wolf-Georg Ringe eds., 2018)

[7] *See*, e.g., Steven N. Kaplan, Frederic Martel & Per Strömberg, *How Do Legal Differences and Experience Affect Financial Contracts?*, 16 J. OF FIN. INTERMEDIATION 273 (2007)

[8] *See* section 2.3.

[9] *See* section 3.

arrangements in some jurisdictions, potentially discouraging deals and the expansion of the market for innovative firms.[10] Empirical evidence also shows that, when given the opportunity, entrepreneurs favor corporate laws perceived to offer higher *economic freedom*,[11] even when such decision deprives them of tax savings, an indication that overlooked differences in specific legal rules matter.[12]

To account for those differences and how they changed over time, I used *leximetrics*[13] to build the *Index of Economic Freedom in Corporate Law* for four Latin American countries: Chile, Colombia, Mexico, and Peru. In it, legal rules are classified and assigned a value based on how much freedom they give participants to regulate the rights and obligations governed by them. The index is comprised of 26 variables in three broad categories that frame the governance of private corporations: *boards*, *shares* and *shareholder agreements*.

The results provide three general insights. The first is that there are relevant differences in the corporate legal rules that govern the allocation of cash flow and control rights in non-listed firms (e.g., the powers to regulate the board or the enforceability of shareholder agreements), which could potentially constraint their ability to access external finance. The second is that there is a trend towards expanding economic freedom, particularly in the regulation of shares. That such a trend started in the first decade of the new millennium suggests that the World Bank's *Doing Business* project might have encouraged comprehensive reviews of corporate law, beyond the regulation of entry; however, a closer analysis of the data shows that the influence, at most, was indirect. Finally, the study shows that, unlike

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10 *See* Zenichi Shishido, *Does Law Matter to Financial Capitalism: The Case of Japanese Entrepreneurs*, 37 FORDHAM INT'L L.J. 1087, 1090 (2014).

11 At the risk of simplification, "economic freedom" is the autonomy that firms' participants enjoy to control or regulate their rights. To the extent that it is not attached to a contractarian approach to corporate law, it is preferred over more common expressions, such as "contractual freedom" or "private ordering." On the limits of the contractarian approach, *see* John Armour & Michael J. Whincop, *The Proprietary Foundations Of Corporate Law*, 27 OXFORD J. OF LEGAL STUD. 239 (2007), and Henry Hansmann & Reiner Kraakman, *The Essential role of Organizational Law*, 110 YALE L. J. 387 (2000).

12 *See* section 3.

13 The term *Leximetrics* was introduced by Robert Cooter & Thomas Ginsburg in 2003 to conduct "comparative quantitative analysis of legal instruments," and has been used extensively in quantitative studies of corporate and labor law, among others. *See* Robert Cooter & Thomas Ginsburg, *Leximetrics: Why the Same Laws are Longer in Some Countries than Others* (U. Illinois Law & Econ., Working Paper No. LE03-012, 2003). *See also* Mathias Siems, *Taxonomies and Leximetrics*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE, 228 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018), and Zoe Adams et al, *The CBR-LRI Dataset: Methods, Properties and Potential of Leximetric Coding of Labour Laws*, 33 INT'L J. COMP. LAB. L. & INDUSTRIAL REL. 59 (2017)

public corporations, non-listed firms' corporate governance legal framework is not influenced by major economic events, such as structural reforms or economic integration.

The paper is divided in six sections. Section one shows that an increasing number of private firms in all continents no longer fit the "family-owned and local business" framework, prevalent in legal scholarship. Section two discusses the relevance of the corporation and corporate law for these firms and why it has been insufficiently studied. Section three details why boards, shares and shareholder agreements are relevant for private corporations' governance and access to external finance. Section four explains the coding process. Section five and six present the results and implications, respectively, followed by a conclusion.

2. The Expanding Significance of Non-Listed Firms

Non-listed companies have gathered increasing attention among policy-makers around the world. They represent over 90% of registered businesses and are responsible for the majority of new jobs.[14] Although many still operate locally and are owned or controlled by a family, escalating beyond those boundaries at a rapid pace is a global trend[15] that challenges traditional accounts on how they operate, as well as what are their governance structures and financial needs.[16]

In the first two decades of the new millennium, an ascending number of private companies have developed innovative products and services that not only capture significant segments of relevant markets, but also control them or even create new markets. The so-called "unicorns"—i.e., companies with a private valuation of over a billion dollars—are the quintessential representation of a global trend.[17] *Airbnb*

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[14] *See* INT'L TRADE CENTRE, SME COMPETITIVENESS OUTLOOK (2019); INT'L LAB. ORG, SMALL MATTERS: GLOBAL EVIDENCE ON THE CONTRIBUTION TO EMPLOYMENT BY THE SELF-EMPLOYED, MICRO-ENTERPRISES AND SMES (2019); and OECD, SME AND ENTREPRENEURSHIP OUTLOOK 2019 (2019)

[15] *See* RICHARD FLORIDA & IAN HATHAWAY, RISE OF THE GLOBAL STARTUP CITY: THE NEW MAP OF ENTREPRENEURSHIP AND VENTURE CAPITAL (2018) (demonstrating, with over ten years of data from companies and investors from 60 countries, that there is an increase in the number of startups—i.e., new fast-growing private firms—that access external finance).

[16] For an overview of those challenges, *see* Lorraine Uhlaner, Mike Wright & Morten Huse, *Private Firms And Corporate Governance: An Integrated Economic And Management Perspective*, 29 SMALL BUS. ECON. 225 (2007).

[17] The term was coined by venture capitalist Aileen Lee in 2013, to highlight how unusual it was for private companies to reach such valuations at that time. Lee merely considered US software companies and found only 39. The latest global account, which includes companies in all industries, identified over 400 companies, many in emerging markets, such as China, India and Brazil. *See* Aileen

and *Uber* (before going public) attracted much of the public's attention, due to their millions of users and clients around the world, and for innovative business models that encourage regulatory changes.[18] These and other U.S. unicorns, however, are just the tip of an iceberg. *Go-Jek*, for instance, is an Indonesian startup offering transportation, payment and delivery services to hundreds of millions of customers, as well as working opportunities to millions. In less than ten years, it reached a 10 billion dollar valuation, partnering with over "2 million drivers…and 400,000 merchants."[19] In Colombia, *Rappi* transformed a poorly developed market for food delivery and managed to raise 1 billion dollars in 2019, which allowed it to strengthen its expansion to greater Latin America.[20] In Nigeria, *OPay* and *PalmPay*, two *fintech*[21] startups founded in 2019, raised over $200 million dollars in just a few months.[22]

Although this phenomenon is largely linked to technological advancements and changes in consumers' preferences, private companies have also benefited from an ongoing expansion of the financial resources available for them. Venture capital (VC), which generally refers to equity investments in "early-stage businesses that offer high potential but high risk,"[23] is no longer restricted to Californian tech companies but available for businesses around the world.[24] In fact, the *2019 National Venture Capital Association Yearbook* reported a continuous increase in

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Lee, *Welcome to the Unicorn Club: Learning from Billion-Dollar Startups*, TECHCRUNCH (Nov. 2, 2013), https://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club/(last visited Feb. 10, 2020), and CB INSIGHTS*, The Global Unicorn Club*, CB INSIGHTS, https://www.cbinsights.com/research-unicorn-companies (last visited Feb. 10, 2020)

[18] These and other companies for which "changing the law is a significant part of [their] business plan," tend to mobilize users and other stakeholders. Jordan Barry and Elizabeth Pollman defined this practice as "regulatory entrepreneurship." *See* Elizabeth Pollman & Jordan Barry, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. 383, 383 (2017)

[19] Manish Singh, *Gojek Founder and CEO Nadiem Makarim Resigns to Join Indonesian Cabinet; Soelistyo and Aluwi to be New Co-CEOs*, TECHCRUNCH (Oct. 21, 2019) (last visited Feb. 10, 2020). For updated valuation information, *see The Global Unicorn Club*, CB INSIGHTS.

[20] Mary Ann Azevedo & Natasha Mascarenhas, *Colombian On-Demand Delivery Unicorn Rappi Raises $1B From SoftBank*, CRUNCHBASE NEWS (Ap. 30, 2019), https://news.crunchbase.com/news/colombian-unicorn-rappi-reportedly-raising-1b-from-softbank/ (last visited Feb. 10, 2020)

[21] "Fintech" refers to a "wide universe of innovative technology-enabled financial services." *See* Saule Omarova, *New Tech v. New Deal: Fintech As A Systemic Phenomenon*, 36 YALE J. ON REG. 735 (2018)

[22] Jake Bright, *Lessons from M-Pesa for Africa's new VC-Rich Fintech Startups*, TECHCRUNCH (Dec. 4, 2019) https://techcrunch.com/2019/12/04/lessons-from-m-pesa-for-africas-new-vc-rich-fintech-startups/ (last visited Feb. 10, 2020)

[23] William A.Sahlman, *The Structure and Governance of Venture-capital Organizations*, 27 J. FIN. ECON. 473 (1990)

[24] *See* Joshua Aizenman & Jake Kendall, *The Internationalization of Venture Capital*, 39 J. ECON. STUD. 488 (2012) (providing evidence of the accelerated pace of internationalization since the 1990s).

global venture investments, with the share going to U.S. companies declining from 84% in 2004 to 51% in 2018.[25] The rise of global VC investments is crucial for the development of innovative businesses, as these investors not only provide capital, but also various value-adding services, such as board professionalization and access to business and financial networks.[26] Naturally, governments are taking note. Reforms facilitating or even promoting investments in private companies through VC are on the rise.[27] Angel investors, which are usually wealthy individuals with startup experience, complement VCs, by financing the development of a product or a business model, even before they are tested in the market.[28]

The contraction of stock markets[29] and the decline in initial public offerings (IPO) in the United States[30]—a symptom of global changes in capital markets—[31]

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[25] NAT 'L VENTURE CAPITAL ASS 'N, 2019 NAT 'L VENTURE CAPITAL ASS 'N Yearbook, 12 (2019), https://nvca.org/wp-content/uploads/2019/08/NVCA-2019-Yearbook.pdf

[26] Thomas Hellmann & Manju Puri, *Venture Capital and the Professionalization of Start-Up Firms: Empirical Evidence,* 57 J. OF FIN. 169 (2002) (concluding, from an analysis of hand-collected data from surveys, interviews and commercial databases, that "venture capital is related to a variety of professionalization measures, such as human resource policies, the adoption of stock option plans, and the hiring of a marketing VP."). *See,* generally, PAUL GOMPERS & JOSH LERNER, THE VENTURE CAPITAL CYCLE (2d ed. 2004)(1999)

[27] An example is Chilean Law 20.190 (2007), which introduced a simplified corporate form and tax benefits for investments in VC funds. For analysis on its impact in firm formation, *see* Alvaro Pereira, *Simplified Corporations and Entrepreneurship* (on file with author). Support for lifting the "Volcker" restrictions on banks' investments in VC funds also signal the interest in canalizing resources to startups through VC in the U.S. *See* Andrew Ackerman, *Banks Face Eased Volcker Restrictions on Venture-Capital Funds*, WALL ST. J. (Jan. 27, 2020) https://www.wsj.com/articles/banks-face-eased-volcker-restrictions-on-venture-capital-funds-11580172708 (last visited 10 February 2020)

[28] *See* Judith J. Madill, George H. Haines Jr. & Allan L Roding, *The Role of Angels in Technology SMEs: A Link to Venture Capital*, 7 VENTURE CAPITAL 107 (2005) . (finding, from a sample of 766 technology firms in Canada, that 57% of those that had received private investor financing had also received financing from institutional venture capitalists; only 10% of firms that had not received angel financing obtained venture capital.)

[29] *See* René M. Stulz, *The Shrinking Universe of Public Firms: Facts, Causes, and Consequences*, 2 NBER Reporter (2018), https://data.nber.org/reporter/2018number2/stulz.html (last visited 10 February 2020) (detailing the causes for a sharp decline in the number of listed firms around the world, particularly in the United States, which "went from 23 listed firms per million inhabitants to 11" between 1976 and 2016) *See also* Craig Doidge, Kathleen M. Kahle, George Andrew Karolyi, & René M. Stulz, *Eclipse of the Public Corporation or Eclipse of the Public Markets?*, 30 J. OF APPLIED CORP. FIN. 8 (2018)

[30] After its peak in 1997, US IPOs have decreased dramatically, due inter alia to the cost of listing and compliance obligations, as well as to the globalization of finance. *See* Paul Rose & Steven Davidoff Solomon, *Where Have All the IPOs Gone: The Hard Life of the Small IPO*, 6 HARV. BUS. L. REV. 83 (2016) (finding that only large businesses are capable of surviving the compliance costs and market pressures faced by public corporations in the U.S.). *See also* Les Brorsen, *Looking Behind the Declining Number of Public Companies*, HARVARD FORUM ON CORP. GOV. (May 18, 2017) https://corpgov.law.harvard.edu/2017/05/18/looking-behind-the-declining-number-of-public-companies/ (last visited Mar. 3 2020) ("The dynamics in the private capital market have changed significantly, at least temporarily, and allow companies to grow larger and stay private longer. The

have also granted private companies access to funds from sources previously reserved to public corporations. Institutional investors and even banks are investing in VCs and creating special funds for private companies, a practice unconceivable not too long ago.[32] Whether through the acquisition of ventured-backed companies or by participating in startup funds, private equity (PE) firms are also offering an exit to early investors and founders of fast-growing companies,[33] contributing to their proliferation and success.[34]

Governments and intergovernmental institutions, in turn, are establishing funds with the specific purpose of investing in these firms.[35] A notable example is *Yozma Ltd*, which successfully triggered the VC ecosystem in Israel,[36] managing more than 200 million dollars and financing over 50 companies since its creation in

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amount of private investment has grown immensely and takes many forms, including venture capital, private equity and debt financing. Companies that make it to a public offering in recent years have tended to be more mature and have solid business prospects…")

[31] *See* Craig Doidge, George Andrew Karolyi, & René M. Stulz, *The U.S. Left Behind? Financial Globalization and the Rise of IPOs Outside the U.S.*, 10 J. OF FIN. ECON. 546 (2013) (finding that "[f]inancial globalization reduces the impact of national institutions on domestic IPO activity….[enabling] more non-U.S. firms from countries with weak institutions to go public with a global IPO."), and Kathleen Kahle & René M Stulz, *Is the U.S. Public Corporation in Trouble?* (Nat'l Bureau of Econ. Research, Working Paper No. 22857, 2016) (noting that the internet has reduced the costs associated with searching and contacting investors and founders, which used to be a crucial advantage of stock exchanges). *See also* Alex Katsomitros, *The Slow Death of Global Stock Markets*, WORLD FINANCE (Ap. 15, 2019) https://www.worldfinance.com/markets/the-slow-death-of-global-stock-markets (last visited Mar. 3, 2020)

[32] *See* Jeff Schwartz, *Should Mutual Funds Invest in Startups: A Case Study of Fidelity Magellan Fund's Investments in Unicorns (and Other Startups) and the Regulatory Implications*, 95 N. C. L. REV. 1341 (2016). *See also* Sergey Chernenko, Josh Lerner & Zeng Yao, *Mutual Funds as Venture Capitalists? Evidence from Unicorns* (Nat'l Bureau of Econ. Research, Working Paper No. 23981, 2017)

[33] Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs* (Nat'l Bureau of Econ. Research, Working Paper No. 26317, 2019) (providing evidence that private investors have financed the growth of the largest startups, which previously was only possible through an IPO.).

[34] Private equity has proven to improve firm performance. *See*, e.g., Douglas J. Cumming, Mike Wright & Donald S. Siegel, *PE, Leveraged Buyouts and Governance,* 13 J. CORP. FINAN., 439 (2007) and Steven N. Kaplan & Per Stromberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSPECT. 121 (2009).

[35] Recent empirical evidence indicates that government funds increase overall finance to non-listed companies. *See* James A. Brander, Qianqian Du & Thomas Hellmann, *The Effects of Government-Sponsored Venture Capital: International Evidence*, 19 REV. OF FIN. 571 (2015) (finding, from a sample of 20,446 companies—in 25 countries —receiving equity investments in an eight-year period, that "markets with more [Government Sponsored Venture Capital (GVC)] funding have more VC funding per enterprise and more VC-funded enterprises, suggesting that GVC finance largely augments rather than displaces [private venture capital] finance.")

[36] *See* Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067 (2003), and Gil Avnimelech & Morris Teubal, *Targeting Venture Capital: Lessons from Israel's Yozma Program*, in FINANCIAL SYSTEMS, CORPORATE INVESTMENT IN INNOVATION, AND VENTURE CAPITAL, 85 (Anthony Bartzokas & Sunil Mani, eds. 2004)

1993.[37] In China, the government-backed *Shenzhen Capital Group* has invested in more than 900 companies in multiple countries, from which 145 have been "listed in 16 different capital markets worldwide," since its creation in 1999.[38] More recently, intergovernmental efforts such as the European *VentureEU*[39] and the Latin American *Pacific Alliance Venture Capital Fund*[40] are offering further financing alternatives for private companies in those regions.

While markets have gradually adjusted to the expanding significance of non-listed firms, the study of corporate law and its influence in their governance and financial structure has stagnated.[41] The next section discusses the main reasons why the corporate form and corporate law have been overlooked by financial and legal scholarship, notwithstanding their proven relevance for fast-growing firms.

3. Corporate Law and Non-listed Firms: an Overlooked Link

3.1. The Corporation and Corporate Law

The corporation (or joint-stock limited liability company) is the most common legal form for business organization, recognized in virtually all market economies, due to essential features that have proven to enhance the finance and growth capabilities of large-scale and long-term business ventures. Limited liability protects owners' assets from the firm's creditors, promoting riskier business endeavors and efficient management.[42] Legal personality—i.e., the legal recognition of its own rights and

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[37] YOZMA, *Overview*, http://www.yozma.com/overview/default.asp (last visited Feb. 12, 2020)

[38] CHUNCHBASE, *Shenzhen Capital Group*, https://www.crunchbase.com/organization/shenzhen-capital-group#section-overview (last visited 12 Feb. 2020)

[39] EUROPEAN COMMISSION, *VentureEU: €2.1 billion to boost venture capital investment in Europe's innovative start-up*, (Apr. 10, 2018), https://ec.europa.eu/commission/presscorner/detail/en/IP_18_2763 (last visited Feb. 8, 2020)

[40] INT'L DEV. BANK, *IDB supports creation of Pacific Alliance Venture Capital Fund* (Apr. 6, 2016), https://www.iadb.org/en/news/idb-supports-creation-pacific-alliance-venture-capital-fund (last visited Feb. 8, 2020)

[41] For a comprehensive account of how the expanding significance of non-listed firms challenges traditional theories and debates in corporate law and governance, *see* Robert Bartlett & Eric Talley, *Law and Corporate Governance*, in THE HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE 177-234 (Benjamin E. Hermalin & Michael S. Weisbach eds., 2017)

[42] Management efficiency results from the fact that the firm's value is determine by their performance, and not by the owners' assets. *See* FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW, 42–43 (Harvard University Press 1996) (1991).

obligations—reduces transactions costs,[43] and shields corporate assets from owners' creditors, ensuring continuity in time regardless of changes in ownership.[44] Asset partitioning and entity shielding, two proprietary features exclusive of the corporate form that are non-replicable by contract,[45] reduce the cost of credit, as the business' valuation is independent of shareholders' personal assets.[46]

Corporations are also required to have a board of directors, responsible for the business strategy and the election and monitoring of executive officers, among others,[47] and are ultimately controlled by investors, the capital providers, who have the right over corporate net earnings.[48] Crucially, corporate capital is divided into marketable shares of future earnings, not only ensuring that owners can exit without dissolving the business but also offering the ability to capitalize the firm through the issuance and selling of these shares—that is, without recurring to debt.[49]

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[43] Notably, the cost of engaging and amending contracts. *See* MICHAEL C. JENSEN, A THEORY OF THE FIRM, 88 (2000).

[44] Legal personality shields corporate assets from owners and owners' creditors and vice versa, by 'locking in' the capital—participants can trade their rights but not their capital, a feature not offered by other business forms. *See* Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387 (2003) (finding that locked-in capital was a crucial feature of the corporate form for growing businesses in the nineteenth century: "the ability to commit capital generally helped promote and protect the interests of shareholders as a group by making it possible for the entity to invest in long-term, highly specific investments. It also helped protect a wide range of enterprise participants who made specialized investments in reliance on the continued existence and financial viability of the corporation.")

[45] Hansmann and Kraakman introduced the concept of "affirmative asset partitioning" to note that, by law, corporate owners' personal creditors cannot execute against corporate interests. Building upon it, Armour and Whincop demonstrated that property law also assists corporate law in more general aspects that minimize "the costs imposed on third parties by this protection." To the extent that these *property* foundations are *legal*, they cannot be replicated by contract. *See*, respectively, Armour & Whincop, *The Proprietary Foundations Of Corporate Law*, *supra* note 11, at 243, and Hansmann & Kraakman, *The Essential role of Organizational Law*, *supra* note 11 at 394.

[46] Corporate creditors are not only protected from the personal creditors of the corporations' owners but also from opportunistic attempts of one owner against the others, which can affect the continuity or stability of the business—e.g., granting entitlements to third parties.

[47] *See,* generally, John Armour et al. *What is a Corporation?, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, 1–28 (John Armour, Luca Enriques et al. eds., 3rd ed. 2017) (2009).

[48] Id. A differentiating aspect from partnerships and partnership-type entities, where ownership is assigned to contributors of labor, as well as cooperatives, in which economic and controlling rights are assigned in proportion of acts of patronage. *See also* Hansmann & Kraakman, *The Essential role of Organizational Law*, supra note 11.

[49] *See*, generally, Charles K. Whitehead, *The Evolution of Debt: Covenants, the Credit Market, and Corporate Governance*, 34 J. CORP. L. 641 (2009), and Allen N. Berger & Gregory F. Udell, *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle*, 22 J. OF BANKING & FIN. 613 (1998). An influential account of the distinctive factors

Due to these characteristics, which gave a competitive advantage to the first corporations in the 17th century,[50] the corporate form became the dominant business entity in contemporary market economies after the industrial revolution.[51]

Most jurisdictions distinguish corporations into "private" and "public." By default, a legal entity with the aforementioned characteristics is a private corporation, governed almost exclusively by corporate law.[52] A corporation *turns* public "by making a public offering of securities, listing securities on a national securities exchange, or by reaching a certain asset size and number of shareholders of record," in which case it is also governed by securities regulations.[53] Naturally, most corporations are private; and a swelling number of public corporations are becoming private,[54] further increasing the relevance of the legal rules that govern them.

3.2. The Apparent Irrelevance of Corporate Law for Non-listed Firms

Notwithstanding the above, the relevance of the corporate form—and corporate law—for private businesses has been consistently questioned or ignored. One traditional account is that, because most non-listed firms have a reduced number of closely related participants, the corporation provides no real advantage over

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between debt and equity finance is in Oliver E. Williamson, *Corporate Finance and Corporate Governance*, 43 J. OF FIN. 567, 583 (1988) ("Debt is a governance structure that works out rules and is well-suited to projects where the assets are highly redepoloyable. Equity is a governance structure that allows discretion and is used for projects where assets are less deployable")

[50] Giuseppe Dari-Mattiacci, Oscar Gelderblom, Joost Jonker & Enrico C. Perotti, *The Emergence of the Corporate Form*, 33 J.L. ECON. & ORG. 193 (2017).

[51] *See* Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1335–403 (2006), Katharina Pistor et al., *Evolution of Corporate Law: a Cross-Country Comparison*, 23 U. PA. J. INT'L ECON. L. 791 (2002), and Margaret M. Blair, *Locking in Capital*, *supra* note 44.

[52] It is important to restate that corporate law has proprietary foundations and, in that sense, it is not a completely isolated legal regime. See Armour & Whincop, *The Proprietary Foundations Of Corporate Law*, *supra* note 11, and Hansmann & Kraakman, *The Essential role of Organizational Law*, *supra* note 11.

[53] Elizabeth Pollman, *Startup Governance*, 168 U. Pa. L. Rev. 155, 163 (2019). The requirements are similar but not identical across jurisdictions. For example, according to Chilean law, corporations become public when they have 500 or more shareholders, or when 100 shareholders own 10% or more of the standing shares. In Peru, the threshold is 1,000 or more shareholders holding at least 25% of the outstanding shares. *See*, respectively, Ley No. 18.046 (1981), *Sobre Sociedades Anonimas*, article 2., and Decreto Legislativo 672 (Sept 1991)

[54] *See* Alex Katsomitros, *The Slow Death of Global Stock Markets*, *supra* note 31 (offering evidence that that strict regulation and volatility of stock markets, listing costs, and "the explosion of mergers and acquisitions, driven by increasing private equity buyouts," are behind this global delisting trend).

partnerships.[55] Moreover, even when private businesses adopt the corporate form, participants implement *inter alia* equal sharing and management constraining rules to reduce the risk of opportunism by controlling shareholders; and, because those types of arrangements are better addressed by partnership law, it is the law of partnerships and not corporate law which matters for the governance of non-listed firms.[56]

While partnerships are not generally considered the optimal form for expanding businesses, the relevance of the corporation and corporate law is also overlooked by comparative studies of non-listed firms, which have advanced research in other topics. Most qualitative studies discuss the characteristics of different types of private businesses and the potential benefits provided by new hybrid forms, with elements from partnerships that could better satisfy the needs of heterogeneous groups of businesses and investors.[57] Concomitantly, a rich series of quantitative studies measuring the impact of reforms facilitating business registration has emerged over the past two decades.[58] Emphasis on the registration of *businesses*—as opposed to *corporations*—has distanced the academic discussion from the role of corporate law in the governance of non-listed firms, guiding it towards the relationship between such requirements and entrepreneurship.[59] Overall, interest in new legal forms and business registration reforms has increased at the expense of the study of corporate law and its influence in the governance of non-listed firms.

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[55] The discussion and main legal literature are summarized in Easterbrook & Fischel, *Close Corporations and Agency Costs*, *supra* note 2. *See also* Timothy Guinnane et al., *Putting the Corporation in its Place*, 8 ENTERPRISE & SOC. 687 (2007) (finding that, in jurisdictions where the law provided some minimal protection against ultimate dissolution of partnerships, such as in the early 1900s France and Germany, private businesses would overwhelmingly choose it over the corporation, without significantly risking their access to external finance. This line of research suggests that widespread dominance of the corporation among business organizational forms is a result of lack of alternatives—mainly in the United States—rather than an inherent superiority).

[56] Easterbrook & Fischel, *Close Corporations and Agency Costs*, *supra* note 2, at 297 ("Equal sharing rules, automatic buyout rights, and strict fiduciary duties are fundamental principles of partnership law and so, sponsors of the analogy contend, also should be fundamental principles of the law of closely held corporations.")

[57] S*ee* Joseph McCahery, *Governance in Partnership and Close Corporation Law in Europe and the United States*, *supra* note 4.

[58] See, *e.g.*, Lars Hornuf & Julia Lindner, *The End of Regulatory Competition in European Company Law?* (Andrássy Working Paper Series No. 33, 2009), Klapper et al., *Business Environment and Firm Entry: Evidence From International Data*, *supra* note 5; and Djankov et al., *The Regulation of Entry*, *supra* note 5.

[59] *See* Pereira, *Simplified Corporations and Entrepreneurship, supra* note 27.

3.3. Corporate Governance and Venture Finance: All About Contracts

The apparent irrelevance of corporate law also contributed to the emergence of the now dominant field of corporate governance, which explores corporate behavior and its relationship with legal rules, markets and institutions.[60] Despite introducing new frameworks that illuminate the understanding of corporations,[61] studies in corporate governance have predominantly focused on listed companies, because of their homogeneity, the availability of data that they are legally required to disclose, and to the salience of corporate scandals affecting investors.[62] While the strength of the corporate governance debate[63] has provoked the adaptation of certain rules designed for public corporations to non-listed ones,[64] the dominant account still sustains that private corporations are governed either by a set of enabling rules

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[60] Ronald J. Gilson, *From Corporate Law to Corporate Governance*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 3, 4 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018) (noting that, since the 1960s and 19070s, scholars in both law and finance agree that corporate law insufficient to explain the behavior of corporations, giving rise to new frameworks that integrate markets and institutions)

[61] For instance, how firm performance is affected by independent directors or different forms of executive compensation. Two seminal works in these topics are, respectively: Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465 (2007), and LUCIAN BEBCHUK & JESSE M. FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004).

[62] Fleischer, *Comparative Corporate Governance in Closely Held Corporations*, *supra* note 6, at 681.

[63] Gilson, *From Corporate Law to Corporate Governance*, *supra* note 60, at 5 (finding that "more than a quarter of all articles published in the Journal of Financial Economics, one of the two leading finance journals, from 1995 through August 29, 2013 were related to corporate governance.")

[64] Joseph A. McCahery & Erik P.M. Vermeulen, *Corporate Governance and Innovation - Venture Capital, Joint Ventures, and Family Businesses* (European Corporate Governance Institute - Law Working Paper No. 65, 2006) ("the costs of designing corporate governance structures that minimizes the expected risks of opportunism and can be enforced by judicial process may be prohibitively high. Thus, policymakers, investors, lenders and other stakeholders prefer to recommend the application of the corporate governance rules and principles tailored to the requirements of publicly held companies.")

from which parties can opt-out,[65] or, where there is a menu of corporate forms, by set of rules that enable parties to opt-in, selecting a given form.[66]

An enabling account of corporate law also prevails in the venture finance literature, which predominantly focuses on the financing of non-listed firms.[67] Unlike studies on business forms and corporate governance, this body of research acknowledges the separation of ownership from control in some private firms.[68] Still, cross-country analysis of contractual arrangements distributing economic and control rights among firms' participants seldom inquiry whether corporate law allows the creation or adjustment of those rights.[69] Although some studies do explore or consider the legal determinants of equity investments in private companies, most of them rely on investor protection indexes, largely based on the laws and regulations of public companies, on rankings of legal systems' efficiency in enforcing contracts or broader measures of the rule of law.[70]

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[65] The traditional proposition is in: Easterbrook & Fischel, *Close Corporations and Agency Costs*, *supra* note 2. A contemporary debate in the U.S., derived from this approach, is the extent to which managers and controlling shareholders of non-listed companies should be allowed to waive their fiduciary duties. Supporters of such a waiver defend the right of a "limited number of participants" to contract out of corporate law. Such a discussion has proved difficult to advance from a comparative perspective, due to the significant differences in the regulation of fiduciary duties, both substantially and procedurally. For an overview of the discussion, *see* Daniel S. Kleinberger, *Two Decades of Alternative Entities: From Tax Rationalization through Alphabet Soup to Contract as Deity*, 14 FORDHAM J. CORP. & FIN. L. 445 (2009); and Lyman Johnson, *Delaware's Non-Waivable Duties*, 91 B.U. L. REV. 701 (2011).

[66] Larry E. Ribstein, *Statutory Forms for Closely Held Firms: Theories and Evidence From LLCs*, 73 WA. U. L. Q. 369 (1995).

[67] For a comprehensive overview of the main literature, *see* Marco Da Rin, Thomas Hellmann & Manju Puri, *A Survey of Venture Capital Research*, in 2 HANDBOOK OF THE ECONOMICS OF FINANCE, 573-648 (George M. Constantinides, Milton Harris & Rene M. Stulz eds., 2013).

[68] In fact, it is often described as a necessary feature for companies financed through equity. *See,* e.g., Erik Berglof, *A Control Theory of Venture Capital Finance*, 10 J. L. ECON. & ORG. 247 (1994) ("the allocation of returns and control…protects the initial contracting parties as much as possible against dilution and extracts from a future buyer of the firm"), and George W. Jr. Dent, *Venture Capital and the Future of Corporate Finance*, 70 WASH. U. L. Q. 1029, 1031 (1992) ("A venture capitalist supplies equity financing but does not assume control of the enterprise.")

[69] For example, it is common to find references to debt that is automatically converted to stock, once an agreed condition is met, a common provision in U.S.-style financing contracts that could have limited application if corporate laws subject conversion to mandatory ratification.

[70] *See*, e.g., Kaplan, Martel & Strömberg, *How Do Legal Differences and Experience Affect Financial Contracts?*, *supra* note 7 (using indexes on investor protection, rule of law and creditor protection—all based on the "legal origin" hypothesis—to account for differences in laws and institutions); and Josh Lerner & Antoinette Scohar, *Does Legal Enforcement Affect Financial Transactions? The Contractual Channel in Private Equity*, 120 Q. J. OF ECON. 223 (2005) (using "legal origin" to classify legal systems' influence in the content of private equity contracts).

It is particularly concerning that contemporary venture finance studies measuring the impact of differences in corporate law and governance[71] rely on indexes distinguishing systems by "legal origins."[72] Such a classification has not only been widely criticized but also debunked by the legal academic community,[73] an indication that its use might have led to inaccurate—yet influential—findings on the extent to which differences in corporate laws can affect the governance structures and financing opportunities of non-listed firms.[74]

4. Economic Freedom: How Corporate Law Conditions the Governance of Non-listed Firms

Despite differing in their conception of the private business enterprise and their influence in scholarship and policy, all previous accounts share two views. First, that the corporate form is likely irrelevant for the governance and financial structure of non-listed firms because those matters are in the domain of contracts. Second, that corporate law is inconsequential or uninteresting because it merely contains enabling rules from which parties can (and often do) contract out. The pervasiveness of these views explains why differences in corporate laws, irrelevant or not, have not been explored by the comparative literature on the governance of private companies.

The facts, however, indicate that at least the first proposition is incorrect. Most private companies that grow beyond traditional frontiers adopt the corporate form,[75] even when that decision reduces tax savings.[76] Moreover, virtually all of

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[71] *See*, e.g., Id., and Douglas Cumming, Daniel Schmidt & Uwe Walz, *Legality and Venture Capital Governance Around the World*, 15 J. OF BUS. VENTURING 54 (2010), and Theodore A. Khoury, Marc Junkunc, and Santiago Mingo, *Navigating Political Hazard Risks and Legal System Quality: Venture Capital Investments in Latin America*, 41 J. OF MGMT. 808 (2015).

[72] Notably, Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998)

[73] *See*, e.g., Holger Spamann, *The "Antidirector Rights Index" Revisited*, 23 REV. OF FIN. STUD. 467 (2010), John Armour, et al. *Shareholder Protection And Stock Market Development: An Empirical Test of the Legal Origins Hypothesis*, 6 J. EMPIRICAL LEGAL STUD. 343 (2009), and Katharina Pistor, *Patterns of Legal Change: Shareholder and Creditor Rights in Transition Economies*, 1 EUR. BUS. ORG. L. REV. 59 (2000).

[74] *See*, e.g., Josh Lerner & Joacim Tåg*, Institutions and Venture Capital,* 22 IND. & CORP. CHANGE 153 (2013) (using the U.S. and Sweden as case-studies to challenge the literature's main findings on the role of institutions—including law: "Our literature survey underscores that the legal environment, financial market development, the tax system, labor market regulations, and public spending on research and development correlate with venture capital activities across countries.")

[75] Indicative of it is that venture capital associations in their model legal documents for new companies recommend the corporate form. *See*, e.g., NAT'L VENTURE CAPITAL ASS'N, *Model Legal*

those firms are financed through the issuance and selling of shares to investors,[77] one of several distinguishing elements of the corporate form that is not replicable through contract.[78] Hence, from an organizational perspective, it appears that the increasing significance of private companies owes a great deal to the corporate form.

To what extent, then, is entrepreneurs' preference for the corporate form related to corporate law? Could it demonstrate that, at least for non-listed firms, corporate laws are uniformly enabling across countries, in the aspects that matter for firms' governance and finance?

While it is tempting to conclude that corporate laws are generally homogeneous (after all, the corporate form has the same essential features everywhere) and that differences are trivial (if participants can, in fact, opt-out), there is evidence that variations in specific rules might frustrate crucial governance arrangements among shareholders.[79] Empirical evidence further shows that, whenever possible, entrepreneurs prefer jurisdictions with higher economic freedom in corporate law, in a broad sense,[80] which indicates that the law could also be determinant for the governance structure of private firms.

Documents, NVCA (2020) https://nvca.org/model-legal-documents/ (last visited Feb. 15, 2020); and BRITISH PRIVATE EQUITY & VENTURE CAPITAL VENTURE CAPITAL ASS'N, *Model Documents for Early Stage Investments*, BVCA (2020) https://www.bvca.co.uk/Policy/Tax-Legal-and-Regulatory/Industry-guidance-standardised-documents/Model-documents-for-early-stage-investments (last visited Feb. 15, 2020). The preeminence of the corporate form is also apparent in directories of startup and venture-backed companies in different countries. See, *e.g.*, LAT. AM.VENTURE CAPITAL ASS'N, 2019 LATIN AMERICAN SATRTUP DIRECTORY, https://lavca.org/vc/startup-directory/ (last visited Feb. 15, 2019) (offering a list of over 300 private firms "in operation that have reported US$1m+ in funding to [Latin American Venture Capital Association] as of Jan. 1, 2019.")

[76] *See* Joseph Bankman, *The Structure of Silicon Valley Start-Ups*, 41 UCLA L. REV. 1737 (1994) (finding that "equity" is a major factor behind Silicon Valley investors' preference for the corporate form, notwithstanding the tax benefits reserved to legal forms in the United States.)

[77] *See* FLORIDA & HATHAWAY, RISE OF THE GLOBAL STARTUP CITY, *supra* note 15.

[78] *See* Section 3.1. *See also* John Armour & Michael J. Whincop, *An Economic Analysis of Shared Property in Partnership and Close Corporations Law*, 26 J. OF CORP. L. 983 (2001) (noting that corporate law has other foundational terms non-replicable by contract, including legal rules on agency, proprietary entitlements and insolvency).

[79] For example, before 2000, Japanese corporate laws prevented investors from exercising control through preferred stock privileges and limited entrepreneurs' ability to strengthen their commitment to the business—e.g., by conditioning the transferability of their stock to vesting plans. Overall, these limitations constrained future deals, preventing or delaying the development and entrance of certain businesses into the market: "In fact, Japanese VCs invest less…than one-tenth of the US averageShishido, *Does Law Matter to Financial Capitalism*, *supra* note 10, at 1090.

[80] *See*, e.g., Carsten Gerner-Beuerle et al., *Why do Businesses Incorporate in Other EU Member States? An Empirical Analysis of the Role of Conflict of Laws Rules,* 56 INT'L REV. L. & ECON., 14 (2018);

To explore those overlooked differences and how they have evolved, the Index focuses on three main vehicles that corporate law offers to allocate ownership and control rights: the *board of directors*, *shares* and *shareholder agreements*.

4.1. Board of Directors

The *board of directors* is at the heart of corporations' governance. It is entrusted with crucial controlling powers, such as hiring and monitoring executive officers.[81] Because private corporations are still perceived as having a controlling shareholder, whose vote is essential to approve decisions at the general meeting (including the appointment of directors), boards' powers are seldom addressed by comparative legal scholarship.[82] However, absent a controlling shareholder, which is common in firms expanding through equity finance,[83] the powers of the board could be instrumental in exercising control. For instance, the law or the charter might condition charter amendments to its approval[84] or even defer to it the ability to issue shares.[85] Representation in powerful boards allows minority shareholders to

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Wolf-Georg Ringe, *Corporate Mobility in the European Union–a Flash in the Pan? An Empirical Study on the Success of Lawmaking and Regulatory Competition*, 10 EUR. COMPANY & FIN. L. REV. 230 (2013); Marco Becht et al., *Where do Firms Incorporate? Deregulation and the Cost of Entry*, 14 J. CORP. FIN. 241 (2008); and Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1987).

[81] See Section 2.1.

[82] See Section 2.2.

[83] Steven N. Kaplan & Per Stromberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281, 287-288 (2003) (finding, in a sample of 118 Silicon Valley startups, that in 60% neither investors nor founders had control of the corporation).

[84] It could be a significant expansion of powers that it already enjoys in most jurisdictions. See, *e.g.*, Brian J. Broughman & Jesse M. Fried, *Carrots and Sticks: How VCs Induce Entrepreneurial Teams to Sell Startups* 98 CORNELL L. REV. 1319, 1328 (2013) (noting that in the United States "the board is also the only corporate body that can initiate fundamental transactions, such as mergers, IPOs, and dissolutions"). A similar account is in Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 301–03 (2001)

[85] Boards could be empowered with the right to issue preferred stock and determine its privileges at the issuance moment, a practice commonly referred to as blank check preferred. *See* JOSEPH W. BARTLETT, FUNDAMENTALS OF VENTURE CAPITAL 45 (1999) (noting that such provisions allow the board to negotiate with investors and establish the detailed privileges when issuance of stock is needed.) *See also* EDWIN L. MILLER JR., LIFECYCLE OF A TECHNOLOGY COMPANY: STEP-BY-STEP LEGAL BACKGROUND AND PRACTICAL GUIDE FROM STARTUP TO SALE 21 (2008) (explaining that "blank check preferred stock may be useful in allowing a company to have to go only to its preferred stock investor group, and not back to its common stockholders as well, to approve subsequent rounds of financing.")

retain control over the corporation and protect their interests,[86] which explains why most investors and founders of fast-growing companies attempt to have a sit in the board.[87] Unsurprisingly, studies in venture finance consider that board representation is a strong form of investors' control,[88] allowing them to get more actively involved in strategy, monitoring and other value-adding activities.[89] Still, corporate law can (and often does) constraint the powers of the board and the freedom to regulate them, by subjecting various decisions to mandatory shareholder approval.[90]

To account for differences and changes in the regulation of boards, the Index includes six categories that reflect strategic uses of the board as a control device:

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[86] Jesse M. Fried & Mira Ganor, *Agency Costs of Venture Capitalist Control in Startups*, 81 N.Y.U. L. REV. 967, 978–79 (2006).

[87] Industry experts, Brad Feld and Jason Mendelson highlight that it is almost an investment precondition: "VCs will often want to include a board observer as part of the agreement either instead of or in addition to an official member of the board.") BRAD FELDAND & JASON MENDELSON, 2 VENTURE DEALS: BE SMARTER THAN YOUR LAWYER AND VENTURE CAPITALIST, 79 (John Wiley & Sons, 2019). For Scott Kupor, managing partner at Anderssen Horowitz, one of the world's largest venture capital funds, it is essentially about retaining and using control at the expense of shareholders with different priorities: "probably one the most foundational thing that a board does is to hire (or fire) the CEO. Understandably, so many founder CEOs have been paying much more attention to the composition of the board of directors given historical concerns over VCs being quick to replace the founder CEO." SCOTT KUPOR, SECRETS OF SAND HILL ROAD: VENTURE CAPITAL AND HOW TO GET IT, 50 (2019)

[88] For a review of empirical studies in multiple jurisdictions, *see* Jonas Gabrielsson & Morten Huse, *The Venture Capitalist and the Board of Directors in SMEs: Roles and Processes*, 4 VENTURE CAPITAL: AN INT'L J. OF ENTREPRENEURIAL FIN. 125 (2002)

[89] Hellmann & Puri, *Venture Capital and the Professionalization of Start-Up Firms, supra* note 26. *See also* Thomas Hellmann & Manju Puri, *The Interaction Between Product Market and Financing Strategy: The Role of Venture Capital*, 13 REV. FIN. STUD. 959, 960 (2000) (describing how venture capitalists contribute to management professionalization); Vance H. Fried, Garry D. Bruton & Robert D. Hisrich, *Strategy and the Board of Directors in Venture Capital-backed Firms*, 13 J. OF BUS. VENTURING, 193, 194 (1998) (finding, from interviews with 383 US venture capitalists, "that boards of directors in venture-capital backed companies are more involved in both strategy formation and evaluation."); and Gerard George, Johan Wiklund, & Shaker A. Zahra, *Ownership and the Internationalization of Small Firms*, 31 J. OF MGMT 210–233 (2005) (finding, with data from 889 Swedish private companies, that directors appointed by investors are more supportive of expansion and internationalization strategies). *See also* Harry Sapienza, *When Do Venture Capitalists Add Value?*, 7 J. OF BUS. VENTURING 9 (1992).

[90] The privileges assigned to preferred stock, for instance, have to be approved by shareholders in Colombia. While shareholders can pre-authorize the issuance of preferred stock, such rules restrict board's ability to bargain (i.e., enhance or limit) privileges with investors, which is tantamount to a ban on blank check preferred stock. *See* Ley 1258 (2008), articles 45 and Código de Comercio, articles 382-386. For a discussion on blank check preferred stock, *see* JOSEPH W. BARTLETT, FUNDAMENTALS OF VENTURE CAPITAL, *supra* note 85; and EDWIN L. MILLER JR., LIFECYCLE OF A TECHNOLOGY COMPANY, *supra* note 85.

size, composition, terms, election, power to issue shares, and power to veto decisions.

4.2. Shares

Shares provide their holders rights over the firm's future net earnings (or residual claims to its assets, if it goes insolvent) and rights to participate in the governance of the corporation, through the election of the board of directors and approval of both annual financial statements and fundamental transactions.[91] In principle, each share is entitled to one vote, which ensures that those who hold more shares have more economic and control rights.[92] Most jurisdictions allow the creation of preferred shares—which grant higher economic rights at the expense of controlling rights (e.g., preferred dividend, no vote) or vice versa (e.g., double vote, restricted dividend)—[93] and some jurisdictions allow the creation of different classes and series of shares, whose rights and obligations are regulated in the corporate

[91] Section 2.1

[92] *See*, generally, Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395 (1983) For a review theoretical developments and empirical evidence of the impact of the one-share one-vote rule, see, respectively: Mike Burkart & Samuel Lee, *One Share - One Vote: The Theory*, 12 REV. OF FIN. 1 (2008), and René Adams & Daniel Ferreira, *One Share-One Vote: The Empirical Evidence*, 12 REV. OF FIN. 51 (2008).

[93] For a comparative analysis *see* Aurelio Gurrea-Martínez, *Theory, Evidence, and Policy on Dual-Class Shares: A Country-Specific Response to a Global Debate* (Ibero-American Institute for Law and Finance Working Paper Series No. 3, 2019; Singapore Management University School of Law Research Paper No. 32, 2019). *See also* Lucian A. Bebchuk, Reinier Kraakman & George Triantis, *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, in CONCENTRATED CORPORATE OWNERSHIP, 295-318 (Randall K. Morck ed., 2000) (identifying dual-class stock as a relevant mechanism to exercise control), and Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-country Analysis*, 68 J. OF FIN. ECON. 325 (2003) (offering empirical evidence of the value of increased voting rights in 661 dual-class listed firms in 18 countries) Two influential theoretical accounts are: William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PA. L. REV. 1815 (2013), and Richard M. Buxbaum, *Preferred Stock--Law and Draftsmanship*, 42 CAL. L. REV. 243 (1954).

charter.[94] In the latter scenario, shares operate as control-sharing arrangements among heterogeneous groups of shareholders with divergent priorities.[95]

Because of corporate law's apparent triviality for the governance of non-listed firms, it is often assumed that all jurisdictions allow the creation of series of shares tailored to meet the governance and financial needs of private companies.[96] It comes as no surprise, then, that the corporate governance and venture finance literature consider voting powers a strong form of control.[97] Yet, as with boards, the regulation of shares (in particular votes) varies across jurisdictions and has changed over time,[98] influencing (or at least conditioning) the use of shares as a control-sharing device.

To evaluate relevant variations in the regulation of shares, across and within jurisdictions between 1980 and 2020, the Index has fifteen variables, divided into two categories. The first category, *common stock*, measures changes in the ability to regulate the rights and obligations of ordinary shares in eight variables: voting rights, remote voting, dividend restrictions, transferability restrictions, vesting,

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[94] Despite the absence of a comparative study on the specific *legal* provisions allowing charter regulation of shares in various jurisdictions, there is evidence that they are included in investment agreements. See, e.g. BEAT BRECHBÜHL & ROBERT J. WOODER. 14 GLOBAL VENTURE CAPITAL TRANSACTIONS: A PRACTICAL APPROACH (2004), Douglas Cumming, Daniel Schmidt & Uwe Walz, *Legality and Venture Capital Governance Around the World*, 15 J. OF BUS. VENTURING 54 (2010), Steven N. Kaplan, Frederic Martel & Per Strömberg, *How Do Legal Differences and Experience Affect Financial Contracts?*, 16 J. OF FIN. INTERMEDIATION 273 (2007), Lerner & Scohar, *Does Legal Enforcement Affect Financial Transactions? supra* note 70, and John F. Coyle & Joseph M. Green, *Contractual Innovation in Venture Capital*, 66 HASTINGS L.J. 133 (2014) (describing how they emerged in the United States)

[95] *See*, e.g., William W. Bratton, *Venture Capital on the Downside: Preferred Stock and Corporate Control*, 100 MICH. L. REV. 891, 899 (2002) (describing how preferred stocks are designed to control the board)

[96] Kaplan et al., for instance, identify contractual differences in the privileges assigned to preferred stock in various jurisdictions. However, they do not consider corporate law as a relevant determinant. Instead, they explore how "the legal and institutional environment" (e.g., creditor protection, the efficiency of the legal system, and tax treatment) explains the differences across legal regimes." Steven N. Kaplan, Frederic Martel & Per Strömberg, *How Do Legal Differences and Experience Affect Financial Contracts?*, 16 J. OF FIN. INTERMEDIATION 273 (2007)

[97] For a review of the main corporate governance literature *see* Marco Becht, Patrick Bolton & Ailsa Röell, *Corporate Governance and Control*, 1 HANDBOOK OF THE ECONOMICS OF FINANCE, 1 (George M. Constantinides, Milton Harris & René M. Stulz eds., 2003). The main arguments discussed in venture finance are in Bratton, *Venture Capital on the Downside, supra* note 95.

[98] In Chile, for example, shares with voting restrictions had to be accompanied by economic privileges until 2008. Moreover, privileges of preferred stock could not limit the rights of common stock. These regulations constrained the use of shares in founder-investor bargains, likely resulting in fewer deals, as happened in Japan, prior its 2000 reform. *See*, Código de Comercio (1865), article 436; Decreto con Fuerza de Ley 251 (1931), article 108; and Ley 20190 (2007), article 17. For a discussion on the impact that similar restrictions had in Japan, *see* Shishido, *Does Law Matter to Financial Capitalism*, *supra* note 10.

pre-emptive and appraisal rights, and convertibility of debt to equity. The second, *preferred stock*, identifies changes in the ability to enhance the rights of shares with preferences, in six variables: series of preferred stock, redeemable shares, convertibility of preferred to common, voting rights, anti-dilution, liquidation preferences and rights to amend preferences.

4.3. Shareholder Agreements

Shareholder agreements (SA) are contracts between shareholders of a corporation. In that sense, they could be used as a complementary device to distribute ownership and control, regulating relationships among specific shareholders—e.g., holders of the same type of shares (preferred stock) or shareholders with similar priorities (founders)—or specific situations, such as changes in corporate control.[99] SAs among *all* shareholders could also be functionally equivalent to the corporate charter when corporate law constraints the ability to regulate the board and the shares in that instrument.[100]

Due to the contractual nature of SAs, it is frequently assumed that shareholders enjoy the freedom to stipulate a variety of corporate governance arrangements in them.[101] However, as with boards and shares, corporate law might explicitly ban agreements restricting or conditioning the exercise of a given right (e.g., voting), rendering agreements legally inexistent, null or void.[102] It could also deprive SAs of

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[99] In other words, "corporate law's statutory rules tie control to voting power; shareholder agreements allow the separation of voting and control." Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance* (2020) (last visited, August 3, 2020), at 3 (2020). *See also* Gilles Chemla, Michel A. Habib & Alexander Ljungqvist, *An Analysis Of Shareholder Agreements*, 5 J. OF EURO. ECON. ASS'N 93 (2007) (showing that SAs allow participants to make specific ex ante investments, by restraining future renegotiation)

[100] Id.

[101] *See* Steven N. Bulloch, *Shareholder Agreements in Closely Held Corporations: Is Sterilization an Issue*, 59 TEMP. L.Q. 61, 61 (1986) (stating that SAs "may contain whatever provisions the parties choose.") Such assumption prevails among scholars and practitioners, but not so much among judges. *See* Rainer Kulms, *A Shareholder's Freedom of Contract in Close Corporations – Shareholder Agreements in the USA and Germany*, 2 EURO. BUS. ORG. L. REV. 685 (2001) (finding, from a review of case-law in Germany and the United States, that "there is uncertainty about the shareholders' freedom of contract and the ground rules governing a contractual relationship between shareholders.") Two studies report similar findings in Russia and Hong Kong. *See*, respectively: Suren Gomstian, *The Enforcement of Shareholder Agreements under English and Russian Law*, 7 J. COMP. L. 115 (2012), and Rita Cheung, *Shareholders' Agreements: Shareholders' Contractual Freedom in Company Law* J. OF BUS. L. 504 (2012).

[102] The evolution of Colombian law offers an illustrative example. From 1995 until December of 2008, shareholders who also held a managerial position in the corporation could not be part of shareholder agreements related to *voting*. Such agreements were legally inexistent. Because the law

enforceability under corporate law, which means that signatories could potentially request damages for breach of contract (e.g., compensation for approving a merger against the agreement) but not use them to exercise control (i.e., prevent the transaction),[103] a matter that has been astonishingly overlooked in the literature, notwithstanding their preponderance.[104] When corporate law restricts their enforceability, SAs cannot be used as a control-sharing device.

Corporate law determines the extent to which SAs can complement or supplement the charter in distributing ownership and control. The Index measures changes in the legal rules that govern SAs' enforceability in five variables: voting, dividends, stock transactions, veto and anti-dilution.

5. The Index of Economic Freedom in Corporate Law

5.1. Coding the Law

The Index is comprised of 26 variables. Each variable is a legal rule that governs a particular right over boards, shares or shareholder agreements in non-listed corporations in a given year between 1980 and 2020. The selection of specific rules is informed by the analysis in section three and by innovative uses of corporate law in the financing of private companies—terms first introduced by angel investors and venture capitalists, which are now common in various forms of private equity around the world.[105] Such terms provide useful guidance, as they facilitate the

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was silent on the legality of agreements signed by manager-shareholders in other topics, such agreements remained binding for the contractual parties only. *See* Ley 222 (1995), article 70, and Ley 1258 (2008). For an analysis of this development, *see* Magda Liliana Camargo-Agudelo, *Los Pactos de Socios en el Derecho Colombiano*, 66 VNIVERSITAS 19 (2017).

[103] That is the case in Mexico, where the law explicitly recognizes shareholders' right to freely regulate the exercise of virtually all their rights in such agreements, but conditions their enforceability to judicial decision. In practice, shareholders cannot invoke them to block a decision from the general meeting, unless a judge authorizes an injunction. *See* Decreto Publicado en el Diario Oficial Federal 06-14-2014, artículo 2, modifying Ley General de Sociedades Mercantiles, article 198.

[104] Holger Fleischer, *Comparative Corporate Governance in Closely Held Corporations*, in in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE, 679-720, 688 (Jeffrey N. Gordon and Wolf-Georg Ringe eds., 2018) ("Breaches of shareholder agreements are almost universally subject to liability sanctions. However, these are unlikely to be an appropriate remedy due to the difficulties in proving the damages incurred. As a result, practitioners across the board recommend liquidated damages clauses as an indirect enforcement mechanism.")

[105] *See* FLORIDA & HATHAWAY, RISE OF THE GLOBAL STARTUP CITY, *supra* note 15; NAT 'L VENTURE CAPITAL ASS 'N, *Model Legal Documents, supra* note 75; BRITISH PRIVATE EQUITY & VENTURE CAPITAL ASS 'N, *Model Documents for Early Stage Investments*, *supra* note 75.

identification of features that are relevant for both entrepreneurs and investors (as opposed to legislators) when thinking about leveraging corporate governance for the expansion and growth of non-listed firms.

Value ***1*** (complete freedom) is assigned to rules allowing parties to freely determine the terms of their arrangements (e.g., "the corporation's capital will be divided into shares which can be of different series or classes, as regulated in the charter or bylaws.") It is also the default value, acknowledging that economic freedom is a foundational principle in market economies. Value ***0.5*** (expanded freedom) is given to rules providing a menu of options for parties to select, and value ***0*** (restricted freedom) to mandatory rules from which parties cannot opt-out. Exceptionally, intermediate values (0.67 and 0.33) are used to reflect changes in the strength of the law.[106]

There are two sets of value qualifications, implemented to reflect restrictions to the *exercise* of a given right (as opposed to the regulation by—or bargaining among—the firm's participants), which are exceptionally uncommon but crucial to accurately evaluate the freedom provided by a given legal rule. The first regards restrictions *by* public authorities. When exercising a right requires notifying a public authority, the value is multiplied by 0.67, and when the condition consists of prior authorization, values are multiplied by 0.33.

The second set of value qualifications accounts restrictions *to* certain shareholders' ability to exercise their rights. When the law identifies specific shareholders (e.g. controlling) and subjects the exercise of their rights to a given condition (e.g. approval by the general meeting), the value is multiplied by 0.67. When the restriction is absolute, the value is multiplied by 0.33. Although the latter case there is an absolute restriction, it is only on *some* shareholders.

Taxonomies are also relevant for the identification and classification of rules in the Index. A non-listed corporation is a legal entity with limited liability, legal personality, delegated management, investor ownership and shares that are not

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[106] This practice follows contemporary Leximetric studies. *See*, e.g., Zoe Adams et al, *The CBR-LRI Dataset: Methods, Properties and Potential of Leximetric Coding of Labour Laws*, *supra* note 13; Dionysia Katelouzou & Mathias Siems, *Disappearing Paradigms in Shareholder Protection: Leximetric Evidence for 30 Countries, 1990-2013,* 15 J. CORP. L. STUD. 127 (2015); Helen L. Anderson et al., *Shareholder and Creditor Protection in Australia-A Leximetric Analysis*, 30 COMPANY AND SECURITIES L. J. 366 (2012); and Mathias M. Siems, *Shareholder Protection Around the World (Leximetric II)*, 33 DEL. J. CORP. L. 111 (2008).

traded in public markets.[107] When legal systems have more than one corporate form with these characteristics, preference is given to the least regulated one. Similarly, when a reform introduces a new corporate form that preserves the essential elements but expands freedom in most variables (e.g. by allowing parties to opt-out), the rules that govern such corporate form are considered from then on. In both cases, the rationale is that restrictions to economic freedom in the standard corporate form are not absolute, because parties have a functionally equivalent alternative.

Finally, partnerships and partnership-type entities are excluded on two grounds. First, because, by default, they lack the essential elements of the corporation, which means that parties would have to contractually seek for the benefits of the corporate form, a practice that could prove unsuccessful.[108] Second, because the enforcement of specific governance arrangements might be subjected to partnership law. Hence, when corporate laws are not the default or interpretative rules applying to a given business form that resembles the corporation, such forms are also excluded.

5.2. Panel Jurisdictions

The Index traces the development of economic freedom in the corporate laws of four Latin American countries: Chile, Colombia, México, and Peru. There are three main motivations for the selection of these countries. The first is that they have been historically ignored by the comparative literature, notwithstanding recent notable developments. Mexico, for instance, is considered a hub for Latin American startups,[109] and Colombian corporate laws have inspired a regional model statute under the auspices of the *Organization of American States*,[110] which has in turn been considered a potential international model by the *United Nations Commission on*

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[107] *See* section 2.1

[108] That is because the laws of contracts and partnerships lack the proprietary foundations of corporate law, which—despite varying in strength among legal systems—generally protect "the rights of co-owners against each other's opportunistic attempts to grant entitlements to third parties." Armour & Whincop, *The Proprietary Foundations Of Corporate Law*, *supra* note 11.

[109] In number of venture deals and VC dollars, Mexico only seconds Brazil, the largest economy in Latin America. *See* Mary Ann Azevedo, *As Billions Flow Into Latin America, Its Startup Scene Scales* CRUNCHBASE NEWS (Oct. 9, 2019), https://news.crunchbase.com/news/as-billions-flow-into-latin-america-its-startup-scene-scales/ (last visited 25 March 2020)

[110] *See* OAS, *Ley Modelo sobre la Sociedad por Acciones Simplificada*, AG/RES. 2906 (XLVII-O/17). For an analysis, *see* Francisco Reyes Villamizar, *The Organization of American States' Model Law on Simplified Corporations* , 11 J. CIV. L. STUD. 1 (2018).

International Trade Law (UNCITRAL).[111] The leximetric approach allows the identification of patterns of legal evolution (towards higher or lower economic freedom) in corporate law previously unavailable to understand these and other realities.

The second motivation is that all four countries are the founding members of the *Pacific Alliance*, an economic bloc created in 2011.[112] The *Alliance* currently enables the free movement of people, goods and services in the territory of its member States, and supports common economic policies and institutions, including the creation of an integrated stock exchange, *MILA* (*Mercado Integrado Latinoamericano* or *Latin American Integrated Market*).[113] It is a unique opportunity to shed light on the extent to which an integration process and multilateral discussions on capital market reforms might influence the evolution of corporate law for non-listed firms.

Finally, the forty-year period of observation is one with significant changes in Latin America that might have also impacted the regulation of non-listed firms, such as structural reforms that included the privatization of state-owned enterprises,[114] and the signature of free trade agreements with provisions protecting foreign investors' interests in private firms.[115] Hence, in addition to providing a previously unavailable map of the evolution of corporate law, the Index also propitiates the identification of potential factors driving relevant changes.

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111 *See* UNCITRAL, YEARBOOK 2014, 539-600 (2015).

112 S*ee* JASON MARCZAK & SAMUEL GEORGE, PACIFIC ALLIANCE 2.0 (2016), and Jaime García, *Alianza del Pacífico, ¿Hacia dónde vamos?*, 31 AGENDA INTERNACIONAL 43 (2013). Updated information at https://alianzapacifico.net

113 For an analysis of the stock exchange integration process and future prospects, *see* DIEGO AUVERT & GUILLERMO PERRY, FINANCIAL INTEGRATION IN THE PACIFIC ALLIANCE (2016)

114 The region experienced comprehensive structural reforms, including liberalization of trade and finance. For a summary of those trends and their impact on trade and finance, *see*, respectively, Claudio M. Loser & Martine Guerguil, *Trade and Trade Reform in Latin America and the Caribbean in the 1990s*, 2 J. OF APPLIED ECON. 61 (1999); and Joshua Aizenman, *Financial Liberalizations in Latin America in the 1990s: A Reassessment*, 28 WORLD ECON. 959 (2005).

115 All Pacific Alliance member States have entered into such agreements with the United States and the European Union, and some with other major economies, such as South Korea. Updated information at https://alianzapacifico.net

6. Results

6.1. Overview

The aggregation of the 26 variables for the four countries in the period of interest results in 4,160 observations (26 x 4 x 40 = 4,160), represented graphically in Figure 4.1. The central finding is that economic freedom is guiding the evolution of corporate law for non-listed firms. There is a clear pattern towards higher freedom in all four countries, particularly at the beginning of the twenty-first century. A potential force driving such a trend in that period is the *Doing Business* (DB) annual report, first published in 2003[116] and highly influential ever since.[117] A closer look at the data reveals its influence was indirect.

The changes captured by the Index are in legal rules that condition the governance of private firms, an area that the DB has not evaluated.[118] Thus, the reported expansions of economic freedom in corporate laws are not a straight reaction to poor performance in the DB.[119] Given its focus on business regulation, the DB might have encouraged revisions to corporate law, more generally. To explore that hypothesis, I conducted correlations tests between the Index and the DB's data on "starting a business," "minority investor protection" and "enforcing contracts," finding no significant relationship between them.[120] These findings indicate that the DB's influence in corporate law reforms is generally reduced to its specific topics and that the evolution of legal rules determining the governance and financial structures of non-listed firms follows a different pattern. The experience of Mexico and Peru further supports the existence of different drivers behind reforms.

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[116] The first *Doing Business* report presented data collected from 133 countries in the year 2002. The 2019 report covered 190 economies. *See* http://www.doingbusiness.org/

[117] According to the World Bank, it has influenced over 600 reforms around the world. *See* Id. *See also* Timothy Besley, *Law, Regulation, and the Business Climate: The Nature and Influence of the World Bank Doing Business Project*, 29 J. ECON. PERSP. 99 (2015)

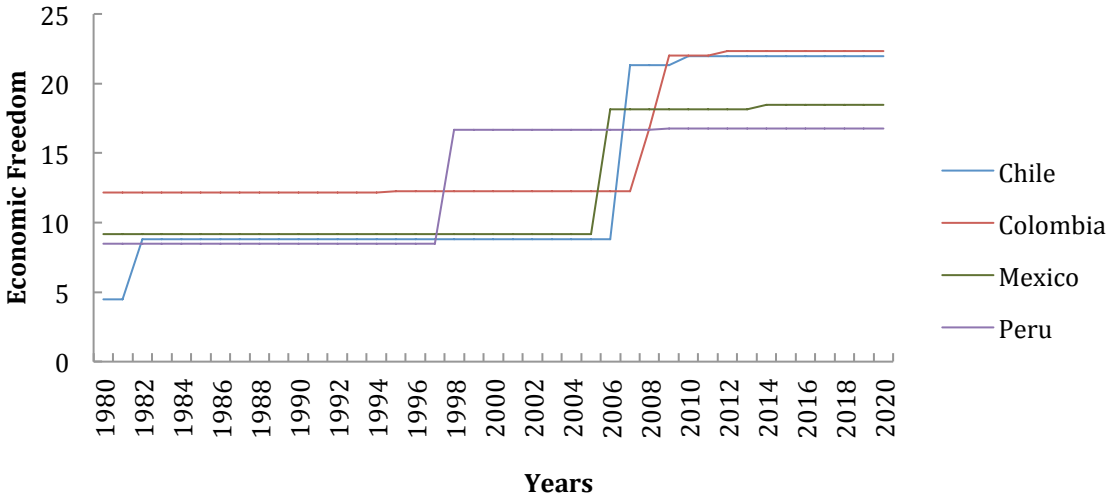
[118] The *Doing Business* Project measures changes in business regulations in ten topics: starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. *See* http://www.doingbusiness.org/

[119] The World Bank's publicly available data on business reforms confirms that those captured by the Index are outside of the DB scope. An updated summary of the reforms considered by the DB since 2008 is available at https://www.doingbusiness.org/en/reforms

[120] The only exception was Colombia's scores in the Index and the DB's "starting a business" component, which have a linear relationship of 0.9.

In 2006, Mexico introduced a new corporate form—the first in the region—that dramatically expanded economic freedom, the *Sociedad Promotora the Inversion* (SAPI).[121] The SAPI was explicitly created to stimulate equity investments in private firms and their access to the stock market,[122] not to improve the country's performance in the DB. Peru, on the other hand, implemented multiple reforms in all three categories of the DB (almost one per year) in the last two decades, but only introduced one governance-related corporate law reform, regulating remote voting.[123] Therefore, it seems that the DB's influence in the *Pacific Alliance*'s evolution of economic freedom in corporate law is, at best, indirect.

Figure 4.1: Evolution of Corporate Laws for Non-listed Firms (1980-2020)



NOTE: *Adjusted to 25 for simplicity. Maximum value is 26.*

The graph also shows that economic integration had no significant impact on the regulation of private companies. The absence of reforms after the creation of the *Pacific Alliance* in 2011 demonstrates that corporate law has remained within the jurisdictional boundaries of its member states, which have uncoordinatedly

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[121] *See* Ley del Mercado de Valores (2005), Diario Oficial de la Federación 12-30-2005 [binding in 2006]

[122] Rodrigo Dominguez & Carlos Treistman, *The Future Of Private Equity In Mexico,* 6 LATIN LAWYER (May 10, 2007) https://latinlawyer.com/article/1085800/the-future-of-private-equity-in-mexico (last visited March 3, 2020).

[123] *See* Decreto Legislativo 1061 (2008) Disposición Final Complementaria - Cuarta, modifying Ley General de Sociedades, article 21.

implemented reforms for private firms that are not captured by the Index due to their irrelevance for governance and finance. Mexico and Peru, for instance, recently introduced a new legal entity for micro-businesses that, despite reduced registration costs and expanded flexibility to regulate the board, has a cap on capital, tantamount to a cap on external finance[124] and thus excluded from the Index.

The expansion of economic freedom is consistent in the forty years of observation, as evidence in the absence of drops in Figure 4.1. A striking implication is that the strengthening of shareholder protection, a global trend involving the restriction of certain freedoms,[125] has not altered the regulation of non-listed firms—at least, not in governance-related aspects.

The graph also exhibits prolonged periods of stability in the regulation. That only Peru reformed the laws during the 1990s reveals that structural economic reforms, prevalent in that decade,[126] did not induce changes in the regulation of private firms.

A detailed examination of the evolution in each country unveils three regulatory strategies shaping corporate law development. The first is introducing a *new statute* for business organizations, as Peru did in 1997. While it made Peru a regional pioneer, the statute has not been updated ever since, an indication that comprehensive reforms might be more resistant to change. A second strategy, followed by Chile (2007) and Mexico (2006), is the introduction of new corporate forms in *broader reforms* aimed at stimulating startup activity.[127] Such reforms, which included regulatory changes—and even incentives—to venture capital funds,[128] have been regularly updated, suggesting that they are more permeable to market fluctuations. The third regulatory strategy is introducing a new corporate form in *a separate statute*, which Colombia did in 2008. By facilitating access to the

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[124] Pereira, *Simplified Corporations and Entrepreneurship, supra* note 27.
[125] *See* Siems, *Shareholder Protection Around the World, supra* note 106.
[126] Loser & Martine, *Trade and Trade Reform in Latin America and the Caribbean in the 1990s, supra* note 114.
[127] For an analysis, *see*, respectively, Pereira, *Simplified Corporations and Entrepreneurship, supra* note 27; and Dominguez & Treistman, *The Future Of Private Equity In Mexico, supra* note 122.
[128] *See* Pereira, *Simplified Corporations and Entrepreneurship, supra* note 27.

rules that govern the new legal entity, the independent legislation contributed to its success,[129] strengthening support for further corporate law reforms.[130]

6.2. Boards

The regulation of boards follows two different trends in the region, represented in Figure 4.2. On the one hand, prolonged stability in both Mexico and Peru, and, on the other hand, abrupt changes in Chile and Colombia on the verge of 2010.

Mexico offers an interesting example of strategic reallocation of freedoms. Its regional pioneer corporate form, the SAPI, significantly enhanced shareholders' bargains, including the ability to regulate the rights and obligations of multiple classes of shares. Yet, it established a cap of 21 directors for SAPIs boards.[131] There is evidence that boards with too many members are infrequent and likely inefficient,[132] which could justify the legislator's decision. Still, the number seems arbitrary, especially considering that most Mexican boards have eight or less directors.[133]

In contrast, Chile and Colombia deregulated boards' size in a single reform that also recognized the right to regulate their composition and the election of their members in the charter.[134] The latter freedoms, traditionally granted by Mexican law,[135] permit the creation of staggered boards, which can be instrumental in preventing premature takeovers of fast-growing companies.[136]

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[129] *See* OSCAR H. GONZÁLEZ BENJUMEA, SOCIEDAD POR ACCIONES SIMPLIFICADA. INNOVACIONES LEGISLATIVAS, DOCTRINALES Y DESARROLLO JURISPRUDENCIAL (2012).

[130] A notable example is dispute resolution. With the issuance of a new Code of Civil Procedure in 2012, the legislator assigned jurisdictional powers over corporate disputes (including those arising from shareholder agreements) to the Superintendence of Companies, an agency traditionally in charge of supervising and controlling all companies. *See* Ley 1564 (2012), article 24.5.
the establishment of a court for corporate disputes in the new Code of Civil Procedure 2012

[131] *See* Ley del Mercado de Valores (2005), article 13.

[132] Benjamin E. Hermalin & Michael S. Weisbach, *Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature* (Nat'l Bureau of Econ. Research, Working Paper No. 8161, 2001).

[133] Sam Podolsky, *Mexico: Corporate Governance Practices* in CORPORATE GOVERNANCE OF NON-LISTED COMPANIES IN EMERGING MARKETS, 223-226, 223 (2006) (finding that "Less than 2% have more than eight principal board members.")

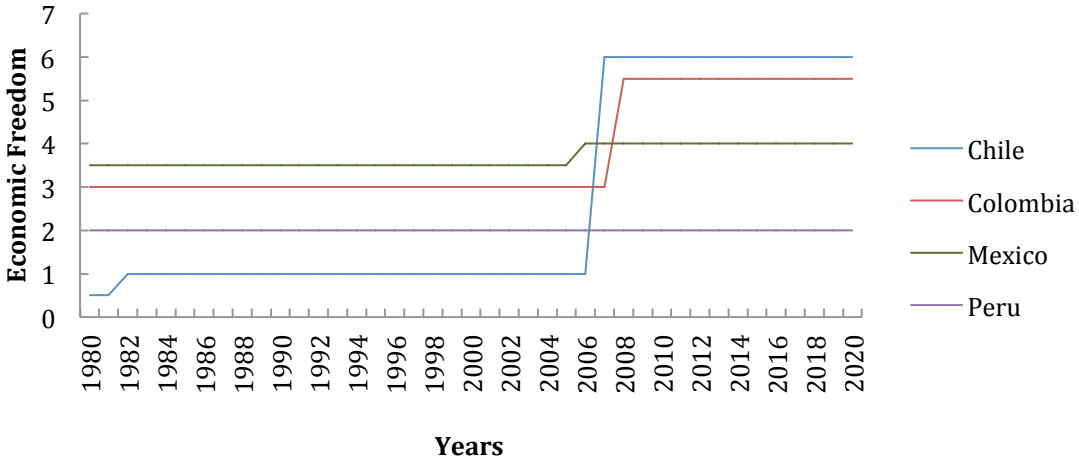
[134] *See*, respectively, Código de Comercio, article 425 (created by Ley 20190 (2007), article. 17); and Ley 1258 (2008), article 25.

[135] Ley General de Sociedades Mercantiles (1934), article 155.

[136] For an overview of the virtues and perils of staggered boards, *see* Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. OF FIN. ECON. 409 (2005).

Peru appears to be the most restrictive jurisdiction for the use of board election in control-sharing agreements, albeit being a former regional pioneer. Interestingly, however, only in Peru and Chile is it possible to empower the board to issue shares of preferred stock and determine its privileges.[137]

Figure 4.2: Regulation of Boards (1980-2020)



Overall, it appears that the regulatory stability of boards in Mexico and Peru could be the result of significant freedoms previously offered by each jurisdiction, potentially in higher demand by fast-growing companies today. Conversely, the graph shows that mandatory rules governed boards of Chilean private corporations until 2007, which might explain the pressure for extensive expansion in a single reform that made it the jurisdiction with higher economic freedom in this sample.

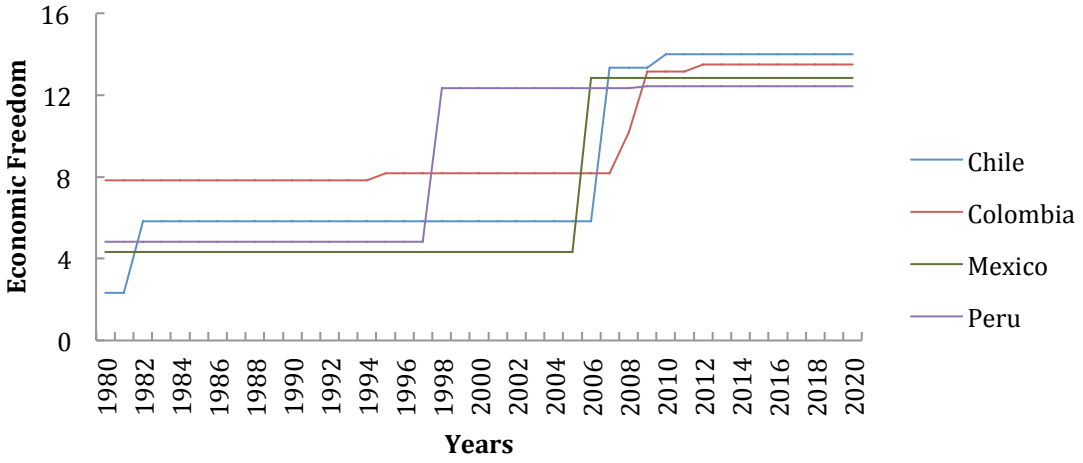
6.3. Shares

Unlike the regulation of boards, which remained relatively stable in Mexico and Peru, the rules that govern shares have been converging towards higher economic freedom in all the panel jurisdictions, as evidenced in Figure 4.3. In that process, there are two patterns. On one end, gradual expansion in Chile and Colombia, particularly in the ability to regulate the rights of common stock. On the other end, single reforms introducing multiple changes in Peru (1997) and Mexico (2006).

[137] *See*, respectively, Ley General de Sociedades, article 83, 98 and 206; and Código de Comercio, article 434 [created by Ley 20190 (2007), artricle 17].

After 2008, the differences are minimal, confirming that shares can generally be used to distribute ownership and control in all four countries.

Figure 4.3: Regulation of Shares (1980-2020)



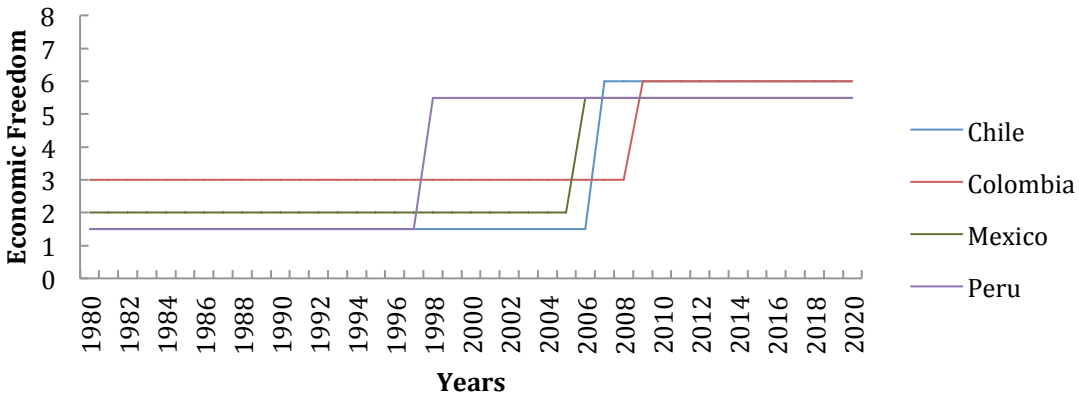
An elusive topic in the evolution of the regulation of shares of common stock is remote voting. While the importance of facilitating shareholder participation is acknowledged in all countries, it remains restricted in Peru (electronic vote requires registered e-signature)[138] and Mexico (distant voting only through a legal representative).[139] It is an unexpected finding, considering that that remote voting is also regarded as a protective measure for minority shareholders,[140] and other countries in the region have sought to allow it.[141]

In this topic, Colombia offers a noteworthy example of how incumbents might be slowing legal evolution. In 1995, a major reform allowed shareholders to participate in meetings from different locations but subjected that right to two conditions that defeated its purpose: a representative of the Superintendence of Companies had to be present, and all outstanding shares had to be represented in the meeting.[142] The law explicitly justified the cumbersome requirements in

[138] *See* Decreto Legislativo 1061, Disposición Final Complementaria – Cuarta (2008), modifying Ley General de Sociedades, article 21.
[139] Ley General de Sociedades Mercantiles (1934), artículo 191.
[140] *See*, e.g., Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. OF FIN. ECON. 3 (2000).
[141] In Chile, for example, remote voting was authorized in 2009. *See* Ley 20.382 (2009), article 2.41 (c), amending Ley 18.046 (1981), article 62.
[142] Ley 222 (1995), article 19.

preventing the majority from being "overrun."[143] While a 2008 reform enabled parties to regulate shareholder meetings in the bylaws of a specific corporate form,[144] it took almost twenty years and comprehensive reform of multiple processes in many fields to eliminate the first requirement for all corporations.[145] The second requirement (participation of all outstanding shares) was eliminated after the Covid-19 pandemic prevented personal interactions.[146] In the latter two cases, the President—not Congress—introduced the reforms, exercising special powers, an indication that changes in corporate law might be exposed to significant resistance from incumbents.

Figure 4.4: Regulation of Shares of Preferred Stock (1980-2020)



The regulation of shares of preferred stock is also converging towards expanded freedom, as evidenced in Figure 4.4. A uniform limitation on the privileges that can be assigned to series of preferred stock is the possibility of amending their own rights, which remains reserved for the general meeting in all four jurisdictions.[147]

The ability to regulate various classes and series of shares is paramount for optimal distributions of cash flow and control rights in investment agreements.

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[143] Id.
[144] Ley 1258 (2008), article 19
[145] Decreto Ley 19 (2012), article 148
[146] Decreto 398 (2020), article 1
[147] *See* for Chile, Ley 18.046 (1981), article 67 and Código de Comercio, article 427; for Colombia, Ley 1258 (2008), articles 9-16; for Mexico Ley del Mercado de Valores — Diario Oficial de la Federación 12-30-2005, article 13; and for Peru, Ley General de Sociedades (1997), article 88.

Thus, convergence towards higher freedom is a strong indication that legislators are interested in enhancing private firms' financing capabilities. It is nevertheless surprising that reforms are unrelated to the economic integration process of the *Pacific Alliance*. The coordinated efforts to harmonize stock market regulation that even led to the creation of an integrated stock exchange, *MILA*, are in sharp contrast with the evolution of the rules that govern the rights of investors in private corporations, which followed the three different regulatory strategies identified in section 5.1. The mismatch is relevant for fast-growing companies and for the development of capital markets in the *Alliance*.

Complex governance and capital structures derived from multiple financing agreements tend to complicate firms' access to stock exchanges.[148] The *Pacific Alliance* can expand firms' exit options in all four countries by facilitating their access to *MILA*, a process that is currently canalized through domestic corporate laws and securities regulations.[149] To the extent that investors in certain states might be exposed to higher legal barriers than in others, a common review of these rules would not only improve firms' access to external finance, but can also contribute to *MILA*'s growth and to capital market development in the *Alliance*.

6.4. Shareholder Agreements

Contrary to conventional wisdom, corporate law in the panel jurisdictions is characterized by pervasive limitations to the content and enforceability of SAs. With the exception of Colombia, SAs are only enforceable as contracts among the signatories, which means that, unless *all* shareholders enter into them, they cannot be used to block a decision (e.g., through an injunction) but rather to seek remedies for harms caused once a decision is taken in breach of the agreement. In Mexico, for example, the law explicitly states that SAs are not enforceable against the corporation, unless there is "a judicial resolution."[150] Corporate laws in Chile[151]

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[148] The divergent interests and contractual arrangements of different shareholders (e.g., investors that joined in different stages), make it difficult to reach an agreement on the best exit strategy. *See* Robert P. Bartlett, III, *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA L. REV. 37, 61-64 (2006)

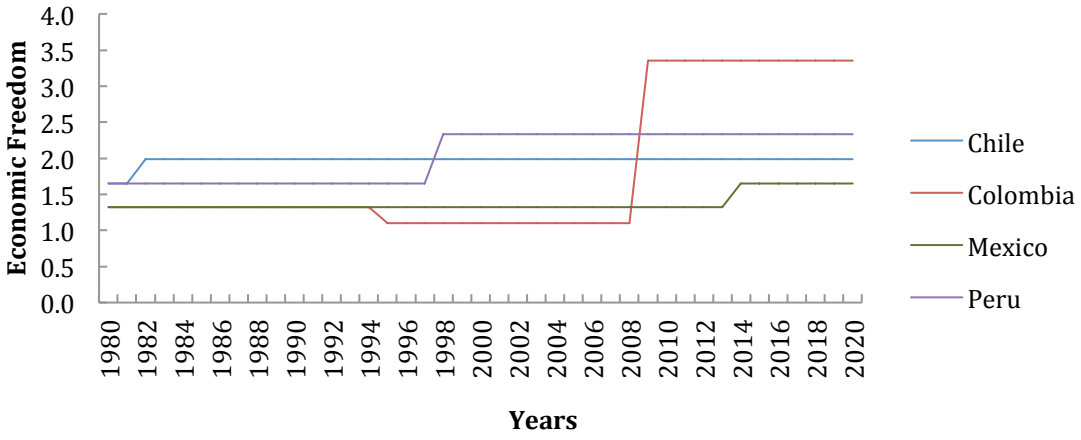
[149] *See* AUVERT & PERRY, FINANCIAL INTEGRATION IN THE PACIFIC ALLIANCE, *supra* note 113.

[150] Ley del Mercado de Valores (2005), Diario Oficial de la Federación 12-30-2005, article 16.

[151] Ley 18.046 (1981), article 14. For an analysis, *see* Osvaldo Lagos Villarreal, *El Mundo al Revés: Pactos de Accionistas, Restricciones a la Libre Cesibilidad de las Acciones y la Reforma al Artículo 14 de la Ley de Sociedades Anónimas*, 22 REVISTA CHILENA DE DERECHO PRIVADO 51 (2014)

and Peru[152] have similar provisions. Hence, in practice, SAs can only be complements—and not substitutes—of governance arrangements in the charter.

Figure 5: Regulation of Shareholder Agreements (1980-2020)



Colombia, again, is an interesting case because it is the only jurisdiction where SAs are functionally equivalent to the charter: the corporation must comply with the agreement (e.g., not counting a vote that breaches them) if a copy is registered in the corporation's headquarters.[153] For over ten years, however, the law explicitly banned agreements related to voting when at least one of its signatories was both a shareholder and a manager.[154] The measure sensibly attempted to reduce opportunism but did not provide certainty on the enforceability of other types of SAs, which were predominantly considered private agreements among the signatories.[155] The recognition of SAs as legally binding instruments that regulate shareholders' rights in private corporations (besides the charter and bylaws), contributed to their use, both as complements and as substitutes of other governance arrangements, and to the development of case law.[156] Therefore, the Colombian experience demonstrates that the expansion of economic freedom in a single legal rule can significantly influence shareholders' ability to reach

[152] Ley General de Sociedades (1997), article 8.
[153] Ley 1258 (2008), article 24.
[154] Ley 222 (1995), article 70.
[155] For an analysis, *see* Magda Liliana Camargo-Agudelo, *Los Pactos de Socios en el Derecho Colombiano,* 135 VNIVERSITAS 19 (2017).
[156] Id.

value-enhancing distributions of cash flow and control rights and, ultimately, private firms' access to external finance.

7. Implications

7.1. For Corporate Law and Governance

This study has three general implications for corporate law and governance. First, it confirms that the traditional characterization of private firms as "family-owned" and "local" must be discarded. Non-listed companies are heterogeneous and increasingly relevant for economies around the world. The increasing economic and social significance of private companies, as well as the acknowledged changes in ownership structures, urge for identification of *legal* rules that limit bargains and governance arrangements. Such rules might be constraining firms' access to external finance, and, ultimately, slowing the expansion of the market for innovative businesses in some jurisdictions.

Second, it highlights the need to develop a trusted framework for comparative legal analysis. Changes in economic freedom might already be generating new problems for non-listed companies around the world without being adequately addressed.[157] The extent to which shareholder agreements can be used to distribute control and cash flow rights is, perhaps, the most contentious topic, in the panel jurisdictions and, likely, elsewhere.[158]

Finally, the study shows that the evolution of corporate legal determinants of private firms' governance is disconnected from two major economic events in the panel jurisdictions: structural reforms that influenced changes in the regulation of listed firms, and the creation of the *Pacific Alliance*. While the sample is too small to make generalizations, this unexpected finding indicates that private firms' regulation is not necessarily aligned with broader economic goals and policies, as is the regulation of listed firms.

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[157] Some of those problems have been recently discussed in U.S. legal scholarship but not comparatively. *See*, e.g., Bartlett & Talley, *Law and Corporate Governance, supra* note 41, and Elizabeth Pollman, *Startup Governance, supra* note 53.

[158] Kulms, *A Shareholder's Freedom of Contract in Close Corporations – Shareholder Agreements in the USA and Germany*, *supra* note 101, Gomstian, *The Enforcement of Shareholder Agreements under English and Russian Law*, *supra* note 101, and Cheung, *Shareholders' Agreement, supra* note 101.

7.2. For Venture Finance

The reported findings have implications for the study of venture finance. First and foremost, they reveal that corporate legal rules can (and likely) influence the content of investment contracts in private firms. In some cases, corporate law limits standard governance arrangements, such as expanding the powers of the board to determine the rights and issue new shares of preferred stock.[159] In other cases, the law appears to recognize freedoms to distribute ownership and control rights in shareholder agreements, but, in fact, it merely allows their use as weak complements—rather than strong substitutes—to the rules that actually govern the firm, which are fenced in the charter and the bylaws.[160] These and other legal boundaries to economic freedom constraint bargains among firms' participants in different levels. Hence, variances in corporate laws matter and, contrary to the prevailing view, investment contracts are insufficient to understand how investors and founders distribute ownership and control in different jurisdictions. (To be sure, to ensure enforceability, lawyers will almost always find a way to adapt a standard arrangement to local rules; however, the selection of a specific instrument (e.g., charter, SAs) and the specific provisions will likely be a reaction to the structure of corporate law and not an evidence of the interests of the parties.)

The findings also confirm that, at least for the regulation of private firms, classifying legal systems by "origins" does not provide any meaningful analytical value. All four countries belong to the civil law tradition, yet the evolution differs in the content,[161] intensity,[162] and regulatory strategies.[163] These disparities among four closely related jurisdictions demonstrate that the "legal origin" of a given system is unrelated to the evolution of its corporate laws.

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[159] For example, Colombian law, despite its expanded freedom (high score in the Index), requires shareholders to approve the privileges of new shares of preferred stock. *See* Ley 1258 (2008), articles 45 and Código de Comercio, articles 382-386.

[160] *See* Section 3.3 and 5.4.

[161] For example, both Chile and Colombia introduced new corporate forms with reduced costs of incorporation as well as expanded freedom to determine the firms' governances. However, only the latter made explicit recognition of shareholder agreements. An even more pronounced contrast is between these two jurisdictions and Mexico, where higher economic freedom was not accompanied by simplification of the regulation of entry.

[162] As evidenced in Figure 4.1, Peru's legal stability contrasts with Chilean and Colombian frequent reforms.

[163] *See* section 5.1

Finally, the findings are a cautionary warning on the use of different indexes and rankings when studying the legal determinants of private firms' governance and access to external finance. Investor protection indexes, for example, are based on the regulation of public companies, which vary in content and follow different paths of legal evolution. The lack of a correlation between the yearly changes in the Index and those captured by the World Bank's "protecting minority investors" ranking confirms that the evolution of both is unrelated. Rankings on legal systems' efficiency in enforcing contracts and ease of registering a business are also unrelated to the evolution of economic freedom in the legal rules that determine private firms' governance.

8. Conclusion

An ascending number of non-listed firms are experiencing fast and unprecedented growth, due to technological advancements and to an expansion of the sources of external finance available to them, which include capital from intergovernmental organizations and even pension funds. This sustained global trend reveals an increasing demand for idiosyncratic governance arrangements, tailored to meet the needs and preferences of heterogeneous stakeholders. Yet, studies on private firms' governance pervasively rely on frameworks that diminish the relevance of the corporation (preferred by fast-growing firms) and corporate law (binding for these businesses), which are respectively assumed to be exchangeable and enabling. An implicit consensus is that the governance of private firms can be crafted through contracts. As a result, the extent to which corporate law conditions the legal instruments and provisions used to distribute economic and control rights in private firms across jurisdictions remains uncertain.

This paper is a first attempt to fill that gap. It introduced the *Index of Economic Freedom for Corporate Law*, which measures changes in corporate legal rules within and across four Latin American countries in forty years. The findings confirm that legal systems differ in the degree of freedom granted for private firms' to structure their governance in the charter and in private agreements. Some of these differences—overlooked by the main literature and unrelated to common classifications of legal systems, such as by "legal origins"—have the potential of frustrating firms' access to external finance.

The investigation also exposes a trend towards higher economic freedom in all jurisdictions, particularly in the ability to regulate the privileges of shares of preferred stock, which accentuated in the beginning of the twenty-first century. While significant differences do persist, evidence of a convergence trend is an indication that legislators are interested in enhancing non-listed firms' ability to raise funds from investors. Such an interest is independent from (or additional to) the pressure generated by the World Bank's *Doing Business* project, which analyses rules that are distinct in content and evolutionary pace. Similarly, this study reveals that, unlike listed companies, changes in the regulation of private firms are not driven by structural reforms, multilateral discussions on capital market reforms or even economic integration. The divergent regulatory strategies through which corporate law evolved in each jurisdiction further corroborate this lack of coordination.

Overall, these findings vindicate the relevance of the corporation and corporate law for the study of non-listed firms. A challenge for studies in corporate governance and finance is to acknowledge differences in legal rules within and across jurisdictions; differences from which parties cannot necessarily contract out and, therefore, are potentially resistant to market and institutional changes.

Chapter Five

Conclusion

Development, even in its most simple conception, is an elusive goal for Latin America. The failure of state-run economies and import substitution industrialization strategies during the twentieth century left painfully valuable lessons for the region, but no blueprint on how to move forward. The privatization of state-owned enterprises and the structural reforms that followed the end of the Cold War have been relatively successful in stimulating growth (a particularly visible outcome after the "lost decade"). However, they have also proven insufficient to produce markets capable of contributing to prosperity.

A pervasive burden keeping even the most dynamic Latin American markets in the "emerging" category is the lack of consideration of how corporate law and governance relate to development goals and priorities. Until the beginning of the new millennium, most rules and principles that shape corporate behavior remained untouched; and the few cosmetic reforms they underwent were generally disconnected from broader economic and social realities and objectives.

In 2003, the OECD White Paper on Corporate Governance in Latin American uncovered how various regulatory frameworks and standardized practices that determine the governance of listed firms were frustrating stock market development and economic growth. Similarly, the publication of the World Bank's first Doing Business Report in that same year exposed how cumbersome legal requirements for the registration of new businesses were likely halting development, by deterring entrepreneurship and perpetuating informality. Despite generating a renewed interest in corporate law and governance, neither of these two influential initiatives compelled policymakers to align the regulation of corporations to broader economic strategies. Instead, they created institutional benchmarks that governments have attempted to transplant or resemble with

insufficient regard to country-specific characteristics. Latin American legal scholarship has been notably absent from these discussions, depriving policymakers of valuable insights on the function and impact of various legal institutions, and how legal rules are used and interpreted in practice ("law in action").

When Chile, Colombia, Mexico, and Peru announced the creation of the Pacific Alliance in 2011, they signaled a change to these practices. Latin America's most thriving open economies were committing to a coordinated and market-based effort to advance economic development. The integration of their stock exchanges under MILA confirmed—if there were doubts—that corporations would be protagonists. However, almost a decade after that landmark announcement and despite successfully lifting restrictions to the movement of people, services, goods and capital, corporate law and governance remain confined in the sovereign cages of the States' legislatures. Whenever possible, each of them has individually introduced reforms that resemble the benchmarks created by the OECD and the Doing Business, not their own aspirations or those of the Alliance.

This compilation of essays provides evidence of the pervasive gap between the regulation of corporations, on the one hand, and three current economic and social challenges that are crucial for the Alliance's goals: sustainability, entrepreneurship, and private firms' access to external finance. Collectively, the essays reveal that the uncoordinated development of corporate law and governance within the Alliance's Member States is likely ebbing away collective efforts. Differences in the laws that regulate the creation and control of corporations, as well as the enforcement of legal and contractual obligations, are likely affecting firms' growth and access to stock markets. Attempts to promote sustainability and stakeholder governance through corporate law reform, albeit recent and more thoughtful, are likely to experience the same fate, given their disparity and incompatibility with other legal and economic policies. Hence, the essays' main conclusion is that intra-Alliance experiences should be prioritized in policy decisions over recommendations from multilateral organizations.

Beyond the Alliance, this work revindicates the *corporation* as a crucial institution to advance sustainability, entrepreneurship, and venture finance, as well as the need to acknowledge relevant differences between legal systems. Contemporary comparative studies in corporate governance and finance predominantly focus on contracts and other non-corporate law determinants of firm behavior, such labor or tax. This compilation offers evidence of fundamental

differences in the legal characteristics of corporations within countries with the same "legal origin," which suggests that basic components of the modern corporation have been absent in emerging economies.

Rethinking the corporation and the legal institutions that shape their behavior in light of evolving development goals is a difficult but necessary enterprise, one that requires the concert of differing minds. It is my hope that the findings and ideas presented here contribute to improving our understanding of how to promote development through thoughtful institutional design. Or, at least, that it stimulates curiosity—even if it comes with animosity—among Latin American legal scholars.

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