

CORPORATE GOVERNANCE AND OWNERSHIP STRUCTURE
OF MEXICAN COMPANIES

A DISSERTATION

SUBMITTED ON

DECEMBER 6, 2006

TO THE PROGRAM IN BUSINESS ADMINISTRATION

IN PARTIAL FULFILLMENT OF THE REQUIREMENTS

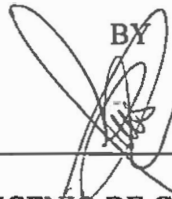
OF THE A. B. FREEMAN SCHOOL OF BUSINESS

OF TULANE UNIVERSITY

FOR THE DEGREE

OF

DOCTOR OF PHILOSOPHY

BY


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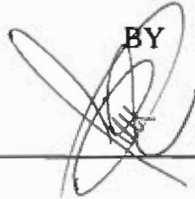
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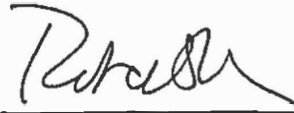
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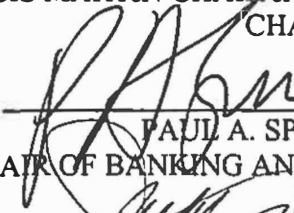


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ABSTRACT

The academic literature on corporate governance is extensive and it covers diverse economies and situations. However, little is known about the mechanisms that discipline corporate governance and control in Mexican corporations. This document makes an examination through a description of these mechanisms using three different approaches: the economic history of Mexican financial markets, the legal system in Mexico, and an empirical analysis of corporate governance characteristics of Mexican corporations. The empirical analysis was made using information from non-financial Mexican corporations with shares listed in the Mexican Stock Exchange (BMV) during the years 1996, 2000, and 2006.

The results of this study indicate that companies currently traded in Mexican markets are 50 years old, on average, and these companies waited 30 years to go public. The economic environment in Mexico suffered from drastic changes and the companies implemented diverse mechanisms to protect their property from external threats including nationalization processes and foreign investor takeovers. The legal system in Mexico is based on the Napoleonic code. However, the regulations applied to corporations are very similar to those that exist in the American economy.

The empirical results of this study indicate that the companies that held large amounts of assets and had American Depositary Receipts in the American markets presented outstanding financial performance and the activity of the boards of these companies was intense. During the years studied, most of the companies in Mexico were family owned business and, on average, almost three family members controlled the voting shares of the entire company. The size of the board of directors and the

percentage of independent directors did not represent a significant difference among the companies studied.

These results support the argument that companies with cross-listings present better financial performance as a result of the law enforcement that is present in developed markets. The argument that the boards of directors collect information from other boards is supported, also.

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This work is dedicated to Mexico; its people, history, and culture.

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Introduction

A decade ago, the terms corporate governance, corporate control, and ownership structure were largely academic jargon. Today, these terms are familiar to almost everyone. Corporate scandals and the international transit of investments in global markets have generated a prominent amount of academic literature.

Basically, the literature on corporate governance considers that four individual mechanisms determine the discipline of corporate control in corporations. These four mechanisms are divided into two groups: external and internal. External mechanisms are those related to the environment in which corporations grow and develop. The legal/regulatory system is the first external mechanism. The legal system is fundamentally important to protect the rights of investors and as well as to deal effectively with agency problems between managers and shareholders. The second external mechanism is the corporate control market. This mechanism is triggered when incentives for outside parties to seek control of the firm rise because of the gap between the actual value of a firm and its potential value is sufficiently negative.

Internal mechanisms are basically those related to the intrinsic structures of the company. A company's board of directors is one of these mechanisms. The boards represent the interests of the shareholders, and, on their behalf, make decisions that affect the value of the corporation. The second internal mechanism is the ownership structure of the company. Ownership and control are rarely separated completely within any firm. While the controllers frequently have some degree of ownership of the equity of the firms they control, some owners, by virtue of the size of their equity positions, effectively have some control over the firms they own as well.

Even though the extensive academic literature exists on corporate governance, little is known about Mexican corporations and financial markets.

The core objective of this research is to provide a descriptive examination of the mechanisms that discipline corporate governance and control of publicly listed Mexican companies from three approaches. First, is the review of the emergence of commercial firms in the context of the economic history of Mexico. Second is a review of the characteristics of corporate governance that have emerged under Mexican mercantile law. The last approach is an examination of corporate governance and ownership structure in Mexican public firms in relation to their operating performance.

This research provides empirical evidence from diverse sources of information to understand the reality of the corporate governance and ownership of Mexican companies.

Chapter One reviews the diverse factors that shaped the external mechanisms of corporate control in Mexican corporations. This review is achieved by the description of the relevant economic facts that occurred in the past 150 years of Mexican history. The legal system is analyzed in the second part of Chapter One. The analysis covers diverse aspects of the regulations applied to corporate governance of public traded companies in Mexico including their incorporation, listing process, mergers and acquisitions, as well as bankruptcy and foreign investment.

Chapter Two provides an empirical description of the two external mechanism of discipline: the corporate governance and ownership structure of public traded companies in Mexican financial markets and their relation to the firms' financial performance. The description covers non-financial companies with voting shares traded in capital markets of the Mexican Stock Exchange (BMV) during the

years 1996, 2000, and 2005. The analysis describes the effects of the cross-listing on corporate governance and ownership structure.

Chapter Three is dedicated to conclusions, mainly to the discussion of the implications of the study, its limitations, and some propositions for further research.

Chapter One
Corporate governance and ownership structure
in the context of the economic history and mercantile law of Mexico

1. The Mexican corporate market

The ownership structure is a key issue in determining the mechanisms of power and control in a company. Every day these mechanisms face the challenge of maintaining the company as it grows in a changing world. Emergent economies, like that of Mexico, have the characteristic of being unstable, even though their prominent expansion on GDP, their levels of risk and their volatility are high.

The public companies in Mexico have operated in a securities market which is more than 150 years old. The age of these firms totals 50 years on average, they have been traded in the market for more than a generation, and, on average, they wait 30 years to become public. Some of these corporations are huge conglomerates which trade in global markets. But, how can a company survive in an emergent economy for so long? Why does a company have to wait 30 years to issue its shares in the markets? What are the economic conditions which permit development of ownership? What is the role of the government? What are the legal conditions which stimulate the growth and protect the ownership? These are some of the questions addresses in this paper.

This document has the main objective of analyzing how the corporations shaped their ownership structure to survive the changing environment of an emergent economy. Two different perspectives are reviewed: The most relevant economic facts in the history of Mexico, and the legal system in which the corporations operate.

2. The economic history of Mexico as a determinant of the ownership structure

2.1 The rise and development of modern corporations

On December 30, 2005, the Mexican Federal Congress passed the “New Law of Securities Market” (LMV). This document replaced the former regulation enacted in 1975. The new law contains significant changes and includes rules related to corporate governance and ownership structure of public traded companies¹. Despite the fact that the Mexican securities market is one of the oldest and second largest in Latin America in terms of market capitalization, never before have companies received such attention and scrutiny at this level.

The recent changes resulted from diverse economic processes experienced by Mexico. For example, 25 years ago Mexico’s development was tied to a model of import substitution in which industry grew to meet the needs of its own internal markets. According to Serrano and Husted (2002), the consequences of this model were highly protected markets from foreign competition and restricted ownership structures in the public companies². At that time, corporate governance was irrelevant to the financial performance of the firms. However, ownership structure played an important role in resisting nationalization and facing changes in the marketplace.

Most of the corporations currently traded in the market have survived these changes. They have adopted mechanisms to protect their property. For example, the average age of a current public company is 50.68 years. Some of these companies were formed in the late 19th century. The oldest firm currently traded in the Mexican Stock Exchange (BMV) is “El Puerto de Liverpool, S.A. de C.V.”, a retail company

¹ In the document, I use the words: Company, corporation, firm and business as synonymous.

² Foreign ownership was usually restricted to a 49% of the voting shares.

based in Mexico City. This company was incorporated in 1847 and its core activity has not change. Other industrial sectors present the same situation including mining companies like “Grupo Peñoles, S.A. de C.V.”, and “Compañía Minera Autlán, S.A. de C.V.”, incorporated in the 1890’s, as well as the brewing firm “Cervecería Cuauhtémoc, S. A.” (FEMSA). Table 1 contains information from 98 non-financial firms currently traded in the BMV. The table shows that the incorporation of the companies has been almost uniform through time. Thus, it illustrates the incentives for opening a business in Mexico have remained, in some manner, unchanged through the years.

[Insert Table 1 about here]

One of the most important decisions for any company is to go public. When a company goes public it collects new capital from investors who gain some relative power in the firm. The figure 1 illustrates the age of incorporation and the age of the initial public offering (IPO) of 98 non-financial companies currently traded in the BMV.

[Insert Figure 1 about here]

These companies represent more than 85% of the total assets from all public firms. The average age of the IPO from currently traded firms is 20.33 years. During the past 150 years, private companies have waited little more than 30 years, on average, to become public. Several factors, all related to ownership structure, may explain this fact. Even though the rules of listing have changed over time and the companies have undergone diverse transformations to acquire control and respond to the markets, most of the companies’ ownership is still concentrated among few individuals.

The mercantile system is federally observed. However, the state in which the company is incorporated plays an important role in the development of the firm. The concentration of resources and close commercial and political relationships are important factors for the firms' survival. According to annual reports from public companies and the Office of Public Record of Financial Securities (RNV), 60.20% of the currently traded non-financial companies are incorporated in Mexico City, 15.31% in the State of Nuevo León, and 6.12% in the State of Jalisco. The rest of the market is located in nine out of 32 states of the Mexican Republic. These statistics indicate that more than 80% of the public companies are based in only three states and evidence concentration. Detailed information is shown in figure 2.

[Insert Figure 2 about here]

The development of corporations has a deep linkage with the role of the government and the implementation of its economic policies. The bodies of corporate control and the ownership structure have evolved to respond to commercial, social, and political situations. What economic conditions did the companies have to face to acquire their current corporate governance? Did these economic conditions persist or are they continually changing? The evolution of modern financial markets and institutions was not always smooth and positive. Extreme changes are common denominators in the economic history of Mexico. In the long run, these changes shaped the ownership and governance of current commercial firms.

According to prominent studies (Bejar and Mendoza, 1991; Aspe, 1993) the evolution of the modern Mexican economy includes six historic periods over the last 150 years. These stages are related to the economic programs the federal government has implemented during this time. The corporate control and ownership structure of commercial companies were shaped during each one of these stages using legal and

market based mechanisms. The economic periods and their relevant facts are presented in table 2.

[Insert Table 2 about here]

The companies currently traded in the market were incorporated during different periods. Figure 3 illustrates the pattern of incorporations correlated to their historic periods.

[Insert Figure 3 about here]

As the reader can see, most of the firms were founded in the period 1940 to 1970. Incorporations during this period represent approximately 39.80% of the current market. After this, the period 1970 to 1985 has 17.35% followed by the last period, 1985 to the present, with 16.33%.

2.2 The regional development and the first modern companies

The first period is before 1910. Even though the 19th century was a time of economic instability and conflicts in Mexico, the primary problem was building one country with one unified system. Regional development shaped most of the economic life in Mexico at that time. The lack of national identity created particular conditions that hindered industrial and commercial development. These conditions included regional law systems. The central region, especially Mexico City, took advantage of the concentration of political power and moved rapidly toward commerce and industrial activities. By the mid-1800's, commercial and textile companies gained strength, and along with mining firms, created an informal market of debt securities. By that time, the north part of Mexico, especially Monterrey city, arose followed the economic development of the US. Monterrey and cities in northern Mexico

established sophisticated and advanced companies specially related to the steel and beverage industries such as “Cervecería Cuauhtémoc, S.A. de C.V.”. These economic activities were financed mostly by family savings, regional commercial banks, and foreign investment. The rest of the country continued working on agricultural and mining activities. The ownership and corporate control were overseen at a regional level.

By the turn of the century, the federal government led by President Porfirio Díaz brought an increase in economic activities. This administration was known for its characteristic of attracting foreign capital because it lacked funds for economic development. To attract these investments the government built roads, railroads, and implemented telephone and telegraph services. The growth of this foreign investment from English, French, and American companies created a demand for a uniform property protection which the government offered in different ways. The regional-based financial system was formalized by the incorporation of the BMV in 1886, and the banking law was declared in 1897. Finally, the “Inspección General de Instituciones de Crédito y Compañías de Seguros”, the former National Banking and Exchange Commission (CNBV), was formed in 1904. Despite of all these economic and financial improvements, the regional development did not favor those states located outside of in the central or northern parts of Mexico.

2.3 Civil war and the Mexican state

The not-industrialized regions suffered from poverty and a high concentration of business ownership and power. In the year 1910, the social problems resulting from the irregular economic development began to get critical. Great

extensions of land were in the hands of a few. The Civil War was declared at this time. This event severely disrupted the economy. The communication improvements of the 19th century were disabled and agricultural and manufacturing distribution became unreliable. The banking system and the public credit, as well as the common currency, disappeared. The lack of a stable federal government caused damage for foreign and private properties. However, not all the regions were involved in this conflict. Foreign investors and Mexican companies began to look at the states as shelters for their capital as the local governments started to offer protection for these investments.

Academics and researchers do not agree on when this conflict ended. Diverse discussions pinpoint the declaration of the Federal Constitution in 1917 as the end of this period. For some economic and law historians, this document was the first of its kind to incorporate specific economic rules for working and production activities, ownership and property, economic policy, and certain restricted industrial activities. Later on, the former Soviet Union would incorporate these kinds of mandatory rules in its Federal Constitution of 1924.

The modern Mexican state was formed during this time. However, this process did not take one day. The main challenge for the new government was to unify the country once again. During the 1920's, several economic institutions were formed. One of the major economic problems was the country's lack of a common currency. Most of the economic activities were financed by gold or silver coins. The Central Bank was incorporated in 1925 and one currency was general accepted: The Mexican Peso. Even though that the Federal Constitution ruled how the federal government must be organized, the lack of strong institutions affected the unity and identity of the new government. In 1929, the Institutional Revolution Party (PRI) was

funded by President Plutarco Elías Calles. Based on state governments, but submissive to the federal administration, this political body would help to bring unity to the republic by informal mechanisms. This party would govern Mexico throughout the next 71 years.

Because of the federal government's constitutional mandate of promoting social equity, the Great Depression of 1929 did not have significant effects on the Mexican economy. By that time, the government had started a nationalization program that covered the railroads, land, and later on, petroleum industries.

To promote new companies, the Federal Congress passed the General Law of Mercantile Societies (LGSM) in 1934. The law is the corner-stone of the mercantile activity in Mexico and it unified the commercial codes of each state. The law was created to promote equal opportunities for businessmen. In that same year the National Bank for Development (NAFIN) was incorporated.

2.4 The economy between 1940 and 1970

By 1940, Mexico's political system reached stability. World War II brought capital inflows, especially from Spain. The effects of the growing American economy were positive for Mexico, too. The economy was based on private and state owned companies. The government started a full import-substitution program to stimulate national output by boosting internal demand. Manufacturing was the dominant industry.

Between 1954 and 1970, Mexico enjoyed an important economic period. The GDP grew average up 7% annually. The US became the main foreign investor. The federal government offered incentives to private companies by protecting domestic

markets from foreign companies, while still supporting the imports of capital goods. The commercial companies were financed mainly by family savings, commercial banks, and government incentives. Commercial firms and state owned enterprises coexisted fundamentally to generate labor for the great mass of workers. The agricultural activities began to have problems related to the ownership of land. During these years the energy industry and the telecommunication sector were nationalized.

By the end of the 1960's, social movements around the globe appeared. The economic development generated by the central bank and government's monetary discipline conflicted with social discontent regarding education and social security. In 1968 a student manifestation inspired by socialistic ideals was repressed by the national army in Mexico City. The death of the students shocked the entire society. These events occurred just days before Mexico hosted the XVI Olympic Games³.

2.5 The economic crises: 1970-1985

As a result of these events, the federal government decided to change the economic model of the country. In 1970, President Luis Echeverria Alvarez's administration began its term. The government became more active in the economy. The social security system was reformed and more State-Owned Enterprises (SOEs) were incorporated with the intention of attaining a multiplicity of goals: the improvement of infrastructure, import substitutions, regional development, and the creation of jobs. The federal administration took advantage of the increasing oil reserves that Mexico had at that time and contracted international loans through the International Monetary Fund (IMF) and the World Bank. Despite the fact that the

³ Mexico has been the only Latin American country to organize the Olympic Games. The notation is important because this historical fact reflects the economic development reached by this country during that decade.

federal government's economic model was designed to increase social welfare, private companies did not like the way the economy was conducted because of the socialistic rhetoric and policies of Echeverria government.

The 1970's, public companies diversified their businesses. Mergers and acquisitions of unrelated companies expanded. This process took place when diverse companies that belonged to relatives or family members joined together in new enterprises. The old model of family businesses incorporated in the late 19th century and in the 1950's transformed into a new type of business: the conglomerates. Currently traded corporations like ALFA, VITRO, CYDSA, and FEMSA (formerly known as VISA) emerged from family businesses based in Monterrey city. This process caused changes in the ownership structure. Dual-class shares began to trade in the BMV. Cross-holdings of securities protected the private property of business. Shareholders felt conflict: on the one hand, they feared nationalization, on the other hand, however, their companies were benefiting from the government's commercial protection. The owners of private companies decided to create civil associations that represented their interest and protected their property against the nationalization process.

Although the Mexican economy maintained its rapid growth during most of the 1970's (6% annually, on average), fiscal mismanagement undermined growth, causing the investment climate to deteriorate sharply. Fiscal problem combined with the 1973 oil shock increased inflation and upset the balance of payments. By 1976, the Mexican peso had devaluated by 45%. During this decade, oil and petrochemicals became the economy's most dynamic growth sector. Rising oil income allowed the government to continue its expansionary fiscal policy. Foreign borrowings expanded also. In 1978, the federal government decided to issue public debt. The "Certificados

Bursátiles” or CETES began to trade in the financial markets. This security is currently traded and it is similar to the America Treasury Bills. With this, the Mexican government stimulated the debt markets.

In the early 1980’s Mexico was beset by falling oil prices, higher world interest rates, rising inflation, an overvalued Mexican peso, and a deteriorating balance of payments. These combined factors spurred massive capital flight. SOE’s totaled 1,155 in 1982 and they participated in nearly every sector of the economy. According to La Porta and Lopez-de-Silanes (1997), subsidies and transfers to SOE’s equaled 12.7% of GDP. SOEs’ output accounted for 14% of GDP, they employed 4.4% of the country’s labor force, and accounted for 38% of fixed capital investment. Mexico’s government did not have enough international reserves and resources to invest continuously in this type of firm. By the middle of 1982 the government declared an involuntary moratorium on debt payments. On September 1, 1982, Mexico nationalized the national commercial bank system.

The macroeconomic situation affected the commercial companies, too. Most of the large corporations had contracted debt expressed in foreign currencies. The devaluation affected their capital structures significantly. To protect the ownership of these companies against future devaluations, the federal government triggered a trust-based mechanism called FICORCA⁴ in 1983. This trust helped the companies with the accounting acceptance of payments they owed in American dollars. With the commercial banks nationalized and it restricted credit, the financial system was basically based on the stock markets.

⁴ FICORCA means Trust for hedging devaluation risks (Fideicomiso de Cobertura de Riesgos Cambiarios). This trust sold American dollars to the Mexican companies with leverage expressed on that currency.

2.6 Privatization and corporate governance

Because of the pressures imposed by its international creditors, the Mexican government changed the economic model again in 1985. This event had occurred by the time Mexico joined the World Trade Organization (WTO, formerly known as GATT) and the same year Mexico City suffered one of the most catastrophic earthquakes in the history of the humanity. The new economic model meant a reverse in the government's fiscal policy and triggered privatization and deregulation processes. During this time, a good number of companies went public. Figure 4 shows that the largest number of IPOs happens in the period after 1985.

[Insert Figure 4 about here]

On October 19, 1987, the BMV suffered –along with almost all the stock exchanges in the world- the “Black Monday” that resulted from the fall of the Dow Jones Industrial Index. That year, Mexican inflation topped 100%.

The turn of the decade brought the privatization of commercial banks, railroad companies, and steel corporations. This process was one of the most extensive in the world in terms of both size and number of companies privatized. By June 1992, 361 SOE's were privatized and the number of firms remaining under state ownership fell to 225. Overall, 96% of all assets of SOE's were sold by the government before 1992. The method of privatization involved first price sealed-bid auctions. Unlike other nations, Mexico never resorted to public subscriptions through the stock market as a privatization mechanism. Before 1993, the government had withdrawn from most sectors of the economy with the exception of oil, petrochemicals, and energy.

In 1994 Mexico joined the North America Free Trade Agreement (NAFTA), along with the US and Canada, creating the largest market on a common territory. The NAFTA international agreement was the first of many. Following NAFTA, the Mexican government signed commercial agreements with the European Union, Japan, Israel, and South America, among others. Each of them had the same argument: Increase capital inflows to the economy through diversified exports and direct foreign investments.

Despite these advances, in December 1994, Mexico faced a new financial crisis. The devaluation of the Mexican peso caused the economic event. This affected all aspects of the economy because of the large amount of debt expressed in foreign currency (especially American dollars) held by financial institutions and the federal government. To preserve the liquidity in the financial system, the Mexican government implemented a program called FOBAPROA⁵ which consisted of a swap of debt securities between commercial banks and the federal government.

Following NAFTA, Mexican and American firms increased their dealings both in numbers as well as in the size of the deals. Mexican acquisitions in the US have historically been rare, and those deals that were made were mostly small in size. Nevertheless, under NAFTA, Mexican companies began to establish themselves as “acquirers” in the US⁶.

American firms, however, are increasingly looking to foreign markets for geographical diversification and, in many cases, for strategic design and growth in industries when domestic markets have matured. The firms watch Mexico closely for expanding operations in a wide variety of industries, including telecommunications, steel, consumer products, brewing, auto parts, publishing, and insurance among

⁵ FOBAPROA was a mechanism similar to the deposit insurance of the commercial banks.

⁶ For instance, according to Dubkovsky and Garcia (2000), combined purchase prices of only three deals (acquisitions Dina for Motorola, Synkro for Kayser-Roth, and Cemex for Lafarge) exceeded 0.7 billion in the mid 1990's.

others. In 2000, BBVA, one of the largest Spanish commercial banks bought Bancomer, the second largest commercial bank in Mexico. Months later, Citigroup announced the acquisition of Banamex, Mexico's largest commercial bank⁷. Citigroup paid 12.5 billions of American dollars for Banamex.

The model evolved strongly toward a free-market economy. Several changes in the financial sector have been made since then. The social security system changed and with this, the pension funds. Internal savings increased from almost nothing to close to 12% of the GDP. The Deposit Insurance Company was incorporated (IPAB) in 1998 and this brought security to Mexico's commercial banks.

In 2000 the PRI, the party that controlled the federal government since 1929, lost the federal elections and the President came from another party for the first time in the history of the modern Mexican government.

Since 2000, the financial system has experienced the largest amount of improvements in its history⁸. The improvements have been focused on increasing the efficiency and fairness of the markets. Despite all of these advances, the access to capital markets remained restricted for medium and small companies. Institutional investors, mainly represented by AFORES⁹ needed minority rights enforcement to direct their funds to public companies.

The legislation on corporate governance has been active even before the corporative scandals in early 2000's. In 1999, the "Consejo Coordinador Empresarial, A.C." (CCE), an organization formed by prominent Mexican businessmen, published a code of best practices on corporate governance for Mexican companies. This code was similar to the one used in England. In 2001, the CNBV and the BMV required

⁷ Canada's Scotia bank acquired Inverlat bank, Spain's Santander Central Hispano from Spain bought the Mexico's third largest commercial bank: Serfin. England's HSBC bought Banco International.

⁸ Between 1998 and 2006, Mexico experienced one of the most extensive deregulation programs in the world. Approximately 30 new laws were enacted in order to protect the private property and give investors a guarantee of fairness.

⁹ AFORES means pension funds in Spanish (Administradoras de Fondos para el Retiro).

public corporation to publish, in their annual financial reports, how well they followed the recommendations about corporate governance from the code of best practices. However, to follow the recommendations of the code was optional. In 2003, a discussion between businessmen and congressmen for improving the LMV of 1975 started. The new institutional investors mostly represented by the AFORES and the foreign funds, as well as diverse macroeconomic studies made by the Organization of Economic and Co-operation Development (OECD), claimed for more protection and certainty for the minority shareholders. With these arguments, supporting it, a new LMV was enacted in 2005.

As the reader can see, Mexico's economy has experienced diverse changes throughout its history. The development of the corporations was linked to the economic programs implemented by the federal government. Modern companies tried to protect their ownership from two types of takeovers: the federal government and the foreign corporations. Each economic period brought mechanisms for protecting the ownership structure that determines corporate control and governance in the corporations.

The past arguments may explain why the Mexican corporations waited more than 30 years on average to issue shares in the Mexican capital market.

3. Corporate governance and law

3.1 The law systems

The market and the law system are the two external elements that determine the corporate governance in a company. La Porta et al. (1998) hypothesize that the

legal system is fundamentally important as an external mechanism to discipline corporate governance. In particular, they argue that the extent to which a country's laws protect investor rights and the extent to which those laws are enforced are the most basic determinants of the ways in which corporate finance and corporate governance evolve in the country.

The literature on finance and law distinguishes among four "families" of corporate legislation: those of English, French, German, and Scandinavian origin (Agosin and Pastén, 2001). The French system offers a moderate degree of shareholder protection (La Porta et al., 1998). However, globalization and deregulation around the world are affecting the way companies implement their governance mechanisms. Nestor and Thompson (2000) found evidence that corporate practices are converging toward a set of common practices. They believe the convergence is occurring because internal company governance profoundly affects the success of individual commercial enterprises.

As in the rest of Latin American countries, Mexico's legal system is based upon the Napoleonic Code. Despite this, the practice of mercantile law by corporations is similar in many ways to that of its American counterparts. Some of the corporate figures present in US companies exist in Mexican firms, too. Table 3 describes broadly, some of the governance practices followed by American companies and how these same practices are present in Mexican corporations.

[Insert Table 3 about here]

The purpose of this section is to provide an overview of Mexican laws that define the legal mechanism and obligations of companies respect its corporate governance and ownership structure

2.2 The Mexican mercantile system

The Mexican mercantile system has two components: The first one is the body of laws mainly formed by the General Law of Mercantile Societies (LGSM), which applies to public and private companies, and the Law of Stock Market (LMV), which applies to those companies that are publicly traded¹⁰. In contrast to American regulations, these laws are federal. The second component is the agencies represented by the Treasury Ministry (SHCP), the National Banking and Securities Commission (CNBV) and the Mexican Stock Exchange (BMV); the last one as a self-regulatory organization (SRO).

The SHCP is the main regulatory agency in the Mexican financial system. The Treasury Minister or Secretary leads the office and is appointed by the President of Mexico him/herself. The ministry's duties are accomplished through four commissions or "arms": The National Banking and Exchange Commission (CNBV), the National Commission for Insurance Companies (CNSF), the National Commission for the Pension Funds System (CONSAR), and the National Commission of Financial Costumers (CONDUSEF).

The LVM gives to the CNBV the authority to oversee the securities industry, including large shareholders (defined as 5 percent shareholders), brokerage firms, securities dealers, the stock exchange, the commercial banks, the development banks, and the social banks. Corporations are required to submit accurate annual and quarterly reports¹¹. The CNBV can submit recommendations for companies to maintain the good practices of commerce. The CNBV is led by its president. He/she is

¹⁰ In 1999 the "Consejo Coordinador Empresarial, A.C." (CCE), a group of Mexican leaders, developed a Code of Best Practices on Corporate Governance. This Code is similar to those used in European countries, especially in the UK. The Code is voluntary and the BMV does require that all listed companies explicitly indicate whether they are in compliance with the Code. If a company is not in compliance, an explanation is required as to why it is not.

¹¹ The financial reports must be presented with information expressed according with the Mexican general accepted accounting principles. The accounting principles are addressed by the National Center of Research on Financial Information (CINIF).

named by the Treasury minister. There are 9 officers appointed by the president of the commission. These observe diverse aspects of the financial system.

The main securities markets are represented by the BMV. The BMV is private and it operates three different financial markets: capital and debt, foreign currencies exchange (ForEx), and derivatives (MexDer). The BMV owns a security-depository company (INDEVAL) and the market transactions are made electronically through a system called SENTRA. The LMV allows BMV to impose regulations on the companies which have securities traded in its markets.

2.3 The structure of corporations

In Mexico, a business can be a sole proprietorship when it is owned by a single person otherwise, it is a corporation¹². According to the LGSM, a corporation is its own legal entity as if it were a person. The incorporation of a business is a process that may take as long as 27 days¹³. This process begins when at least two persons decide to go into business. The starting capital must be at least 50,000 Mexican pesos (this is approximately 4,300 American dollars as of November, 2006). The entrepreneurs must be assisted by a public notary to write the business' documents of incorporation. Under the documents, the corporate name is defined. The corporation's purpose is declared, as well as its bylaws and the description of its main operations. The duration of a corporation is 99 years. If a business lasts longer, another document

¹² The proprietorship is not observed by the LGSM. This type of entity is regulated by fiscal laws under the name of "*Personas Físicas con Actividades Empresariales*". The "Sociedad Anónima" or "S.A." is the most common form of legal organization for a business in Mexico. However, the LGSM allows other forms of partnership.

¹³ According to "World Bank's Doing Business 2007", the process involves diverse registrations in the government's offices like the Treasury Ministry (SHCP), Foreign Affairs Ministry (SRE), State Ministry (SEGOB), etc.

must be notarized¹⁴ in order to extend its term. The document must contain the corporation's address and the name of the registered agent at that address.

At this point, one of the most important matters is that the partners must clarify the ownership structure of their business. At the beginning, it is common that all the shares of the company are voting class and represent "Fixed-Capital"¹⁵. However, since the LGSM allows dual-class shares, the partners could decide to issue another class of shares and stipulate who can acquire these shares in each case¹⁶. If the shares are from the same class, then they must have the same value and the same rights. The rights of the voting shares are on a one-share, one-vote basis. The document must mention when this vote is allowed¹⁷. Table 4 shows the class of shares traded in public financial markets and their characteristics.

[Insert Table 4 about here]

When the company decides to go public, then it starts an IPO process. The LMV addresses this procedure. The investment banks are the legal entities allowed to conduct the IPO process¹⁸. The first step of the process occurs when the firm, by an extraordinary shareholders' meeting, changes its documents of incorporation by an amendment and adopts the modality of corporation called Public-traded Company (SAB)¹⁹. With this, the firm accepts being regulated by the LGSM as well as the LMV. Then, through a prospectus, the firm announces the amount of its capital that is

¹⁴ Recently some important companies have had to face their re-incorporation. CEMEX and FEMSA are two examples of this situation. In 2006, CEMEX reached 100 years of operations.

¹⁵ Usually the capital of the corporation is divided into two parts: Fixed and Variable. The Fixed-Capital is the one that is paid by the owners at the beginning of the life of the company. This cannot be retired and the owners have to do another act if they want to extend this capital. The Variable-Capital is the fraction that can be extended or retired at any time. The changes in the Variable-Capital must be approved by the extraordinary shareholders' meeting.

¹⁶ The rights of foreign investors to acquire shares are limited for some industries.

¹⁷ The one-share, one-vote rule applies for common shares.

¹⁸ The IPO process is similar to the one followed by American markets. Underwriting and road shows are common practices followed by these entities.

¹⁹ The LMV addresses a "path" for medium companies to become public. It indicates two intermediate levels called "Sociedad Anónima Promotora de Inversión" (SAPI) and "Sociedad Anónima Promotora de Inversión Bursátil" (SAPIB). Each level has obligations and they depend on the type of investment that each company requires. The "Sociedad Anónima Bursátil" (SAB) is the level when the company has full access to the financial markets and has all the obligations required by the CNBV and BMV.

going to be traded in the public market, the class of shares that represents this capital, the rights of the new owner, and who can own these securities.

The prospectus must be approved by the CNBV. The new shares must be recorded in the RNV and placed in the INDEVAL before the offering is made. After this, the company must report annual and quarterly financial information to the CNBV and BMV and it has to observe the regulation that governs for public companies.

Since cross-listing is not prohibited in Mexico, the companies can issue securities in foreign markets. Prominent Mexican firms have American Depositary Receipts (ADR's) in the American financial markets²⁰.

2.4 The Shareholders' meeting

Literature on corporate governance usually considers the board of directors and the ownership structure as the internal governance mechanisms (Denis and McConnell, 2003). However, according to the LGSM, the shareholders' meeting is the ultimate body of corporate control of a company in Mexico. Its functions and the way it operates must be described in the corporation's bylaws (LGSM, Art. 178).

²⁰ A foreign firm can cross-list its shares in the US either by listing its shares directly or via an ADR program. Rule 144a ADRs are capital-raising issues that are privately placed to qualified institutional buyers (QIBs) and trade over-the-counter among QIBs. Rule 144a issuers are not required to register under the Securities Act or the Exchange Act, which thereby exempts them from most civil liability provisions as well as both SEC disclosure requirements and U.S. GAAP accounting rules. Level 1 ADRs trade over-the-counter as pink sheet issues. Minimal SEC disclosure is required and home-country accounting is allowed, although the statements must be in English. Level 2 ADRs are securities that trade on a U.S. exchange. Foreign firms like Mexicans, listing via Level 2 ADRs must register with the SEC on form 20-F in accordance with the Exchange Act. Registration obligates the firm to file periodic and other reports with the SEC, including a reconciliation of financial statements to U.S. GAAP accounting. Firms must also meet minimum listings standards for foreign companies set by the U.S. exchanges and satisfy the exchange's corporate governance requirements. Foreign firms can obtain waivers on a case-by-case basis for many of the corporate governance requirements as long as the issuer's practices do not violate the law of the issuer's home country. Level 3 ADRs are similar to Level 2 ADRs, but include a capital-raising element in addition to the listing and the firm must also register on Form F-1 in accordance with the Securities Act. Finally, it is important to note that ADR holders are entitled to vote if the ADRs they hold represent voting shares. The depositary bank usually notifies ADRs holders of matters submitted for shareholders vote. A number of voting arrangements are possible, but typically the depositary will vote only of those shares for which instructions have been received from the ADR holders. See Doidge (2005) for further details.

Corporations hold two classes of meetings: ordinary and extraordinary (LGSM, Art. 179). The characteristics of each class of meeting are expressed in table 5.

[Insert Table 5 about here]

Even though the LGSM addresses the issues or topics that each meeting focuses upon, the agenda is prepared by the board of directors. The LGSM does not mention how and when the proxies have to be completed and delivered to the shareholders. However, the CNBV recommends that these statements have to be delivered at least 15 days before the meeting takes place. All the decisions made during the meetings are recorded in an official document called the Shareholders' meeting act. The acts have to be presented to the BMV.

Increasing shareholder activism has brought changes to the minority rights in public companies. The main rights in public companies are:

1. To name one director if the shareholder has at least 10% of voting shares
2. To oppose by judicial action, a decision made in the shareholders' meeting if the shareholder has 20% of the voting shares
3. To start civil prosecution against the board and officers if the shareholder has at least 5% of the voting shares.

2.5 The board of directors

In the US, the board of directors is charged with representing shareholders' interests. As such, it is the official first line of defense against managers who would act contrary to shareholders' interest. In Mexico, according to LGSM (Art. 142) the board of directors is the collegiate body in charge of the corporate governance of the company. The functions of the board of directors are: to hire, evaluate, and perhaps,

even fire top management -with the position of CEO being the most important to consider- and to offer expert advice to management. This advice must focus on strategic planning and internal control. To achieve its functions, the board must meet at least four times per year.

The integration of the board is a company matter and it is explained in its bylaws. However, the LMV requires that it must be composed of no more than 21 directors. The board is led by its chairman and it can have one secretary. The LMV considers two types of directors: independent and non-independent. The independent directors are those who haven't been officers or employees of the company, and are not shareholders of the firm. Relatives of shareholders or people who could have some sort of influential power in the company cannot be independent directors. The employees, suppliers, and clients cannot be independent directors, either. The LMV requires that at least 25% of the directors from the board must be independent.

The responsibilities of the directors in Mexico are similar those in the US. So, the directors must be engaged with fiduciary, loyalty and fair dealing duties as well as the duty of care, the duty of supervision and the duty not to entrench. The LMV considers the existence of the business judgment rule when reviewing cases involving directors' responsibilities.

The election of directors is an important process. The procedure can vary from one company to another depending on their bylaws. Generally the election starts with the slate addressed in the proxy statement. The slate is made by the nomination committee and it is passed to the shareholders 15 days before the ordinary shareholders' meeting. The election takes place during the shareholders' meeting. The shareholders who own at least 25% of the voting-shares have the right to name one director. This percentage is reduced to 10% if the corporation is publicly traded. The

term of a director is a company's matter, also. However, the common practice among corporations is to have a one-year term for each director, with re-election allowed. Staggered terms are not common in Mexican companies. Usually, Mexican boards have back-up directors. These members can take the place of a director in his or her absence.

To achieve its goals, the board must work in committees. The LMV forced public companies to have at least two: the audit committee and the best-practices committee.

The audit committee is a critical one and must, by LMV regulation, be composed primarily of independent directors. The CEO of the company provides staff assistance for this committee, along with senior accounting managers. The committee must work closely with the external auditing firm. The audit committee's responsibility has been to know what is in the financial statements and to ensure they are accurate and are reported properly to those outside the firm.

The best-practices committee is a corporate body that observes diverse aspects of corporate governance. The LMV requires the committee be formed by independent members. This committee has the primary duties of hiring, evaluating, and compensating CEO and top management.

2.6 The CEO in the Mexican companies

The CEO is the person in charge of direct management in a company. The LGSM stipulates that the board of directors can name one person in charge of the company's operations (LGSM, Art. 145). The LMV describes his/her functions in detail. These functions are: to run the operations of the business and perform the day-

to-day management, propose business strategies to the board of directors, prepare financial information, and be responsible for maintaining the diverse systems in the company (LMV, Art. 44).

The process of CEO election in Mexican companies is, in most of the cases, a family matter²¹. However, the companies that have established the election process in their bylaws usually select the CEO through a nomination committee. The top-management is selected by the CEO who can propose the members of his/her team to the board; the board decides who will be in the top-management.

Among the tasks specifically assigned to the board of directors is that of determining the structure and level of compensation of the top executives of the firm. The compensation issue that is of the greatest interest from a corporate governance perspective is the degree to which executive compensation aligns interests of top executives with those of their shareholders. Accordingly, the CEO's salary and compensation in Mexican companies is, as in other economies, a complicated topic. According to the literature, management compensation must reward strong current performance and simultaneously, provide incentives for similar future results. The corporations are forced to inform the CNBV if their CEO and top officers have some sort of compensation plan, but they are not forced to disclose how much the CEO and company officers receive.

2.7 Mergers and acquisitions

During the last 10 years, mergers and acquisition activities have increased in Mexican economy. Most of the deals have been private; however, mergers and

²¹ Since most of the corporations traded in the BMV are family business, the process of electing a new CEO is more like a succession.

acquisitions occur in public companies, as well, especially in the financial sector. The mercantile law is mainly focused on ensuring fairness in these deals.

A merger process starts with the agreement of both companies. To reach the agreement, each company has to call for an extraordinary meeting. The board of directors usually is the body charged with calling a meeting. However, the meeting could be called by company shareholders or the CEO. To ensure fairness, the meeting is open to non-voting shareholders, too. The shareholders must know, in advance, the terms and conditions of the transaction. The board of directors has to hand out sufficient documentation about the merger or acquisition to the shareholders. A decision is made when 3/4 of the voting-shares vote in one direction. After this, the companies have to communicate their decision to the market. In this case, they have to wait three months to know if there is any party who opposes the merger or acquisition. If no other party opposes during this time, the operation takes place.

The acquisition of a company is one of the most relevant deals in financial markets. This process not only reveals the actual financial performance of a company; it probes the corporate governance of the firm, too. When a company is acquired in a “friendly” way, the problems are reduced significantly. These problems may arise with “unfriendly” acquisitions or hostile takeovers. Mexican law oversees the fairness of the deal, especially with respect to minority shareholders. In each case, companies determine the procedures for the particular deal. The corporation’s bylaws specify the anti-takeover mechanisms. Almost all public companies include clauses with procedures for approval when a shareholder wants to acquire more than 2% of the voting-shares. This approval comes from the unanimous decision of the board of directors. Some companies include procedures like Poisson-pills.

When a company has an acquisition offer, it must call for an extraordinary shareholders' meeting. The board of directors calls the meeting and must send information about the transaction to the shareholders in advance. The acquisition must be approved by 3/4 of the voting-share owners. The acquisition offer must include non-voting shares to be fair to all the shareholders.

2.8 Bankruptcy process

The bankruptcy process is regulated by the Mexican Bankruptcy Law (LGQCM)²². This law oversees the process and determines the costs and payment. Broadly, the process begins when a judge declares the corporation in a state of mercantile contest. A company is declared to be in this state when at least 35% of its financial obligations have moratoria of 30 days, or when the company doesn't have enough liquid assets to pay 80% of its debts in moratoria. After this, if the corporation cannot reach an agreement with its creditors, the judge or the company itself (through the judge) declares bankruptcy.

When bankruptcy is declared, the judge assigns the administration of the corporation to a commissioner. This person will list all the assets of the corporation and call for an auction. The money earned in the auction will constitute a fund for the payments of the creditors. The judge will declare who the creditors of the company are. The payments will be in the following order:

1. Creditors who have bonds guaranteed on specific assets (houses, cars, etc.)
2. The workers and employees

²² "Ley General de Quiebras y Concursos Mercantiles"

3. The government
4. Senior debt holders
5. Junior debt holders
6. Non-voting shareholders
7. Voting shareholders

The owners of the company must keep the records of the transactions for 10 years. The name of the company cannot be used by another firm.

2.9 Foreign investment

Foreign investment has been present in the Mexican economy during its whole modern history and it is regulated by the Foreign Investment Law (LIE). Sometimes, the government has created mechanism to stimulate these investments. In other times, it has established mechanisms to diminish the inflows. To understand the regulation and the mechanisms that protect foreign property, we need to know that there are specific economic industries or sectors where this kind of investment is restricted, or even prohibited.

The LIE (Art. 5) mentions what key economic activities are reserved for the state. These activities are considered strategic for the development of Mexico²³. Other industrial sectors like transportation or gasoline retail are restricted to a certain percentage of foreign investment.

When a company decides to invest in Mexico, it can employ diverse modalities. These include: green investment and joint-ventures. In any case, the foreign investor has to be registered by the office of Foreign Investment Records. This

²³ The foreign investment is prohibited in the following industrial sectors: petroleum, petrochemicals, energy and electricity, nuclear energy, radioactive minerals, telegraphs, public mail, coins and bills, control and supervision of airports.

is led by the Ministry of Economy. Commercial companies must establish the terms and conditions about where their foreign investments will take place in their capital structures. These conditions have to be written in the companies' bylaws.

As we can see, the ownership structure of public companies in Mexico has been shaped by two external mechanisms: the country's economic history and its legal framework. The legal system that oversees the mercantile transactions between particulars is complete in Mexico. If we number the actual regulations present in the Mexican law system and the recommendations from the OECD, the Mexican economy has the sufficient mechanisms in order to maintain the fairness of the transactions. However, one of the main problems is the enforcements of this legal system.

The companies that today are traded in the financial markets are the survivors of the diverse economic processes and a legal system that did not protect the property correctly. Detailed studies need to be done in order to understand the evolution of ownership structure and corporate power of the companies. These studies should be done at a company level and should address such questions as how concentrated is the ownership in a corporation? Who are the owners? How many directors are in a board? What is the relationship between ownership and financial performance?

Chapter Two

Corporate governance and ownership structure of Mexican companies

1. Ownership structure in Mexico

The ownership structure of the equity is one of the main elements that determine the mechanisms of corporate control in companies. According to different studies, a close relationship exists between private property protection in a country and the level of concentration of ownership. In economies with legal systems based on French law, the protection of private property is not as strong as in those economies with a legal systems based on English common law.

Equity concentration and its relation to corporate governance have been empirically studied, and research has considered different economies on different continents. In spite of that, little is known about the structure of equity ownership and corporate governance in the Mexican financial market. The general feeling or perception regarding the financial markets is that Mexican firms tend to be owned by families and the concentration of control inside the families is still strong.

Through a description of the main characteristics of Mexican companies, this chapter aims to analyze the structure of ownership and corporate governance in listed companies in the Mexican financial market. The analysis is based on samples of non-financial companies listed in the capital market of the Mexican Stock Exchange (BMV) for the years 1996, 2000, and 2005.

The analysis is done on a comparative basis, bearing in mind the size of the company (measured by total assets), the cross-listing (taking into account listed securities in American financial markets) and a combination of both.

Research is divided into four sections. In the first, I present a review of literature on concentration of property, corporate governance, and their applications in Mexico. In the second section, the sample and source of information are detailed. Section three analyses corporate governance as well as the structure of property in companies according to their total assets. Finally, section four analyzes companies, taking into consideration their American Depositary Receipts (ADR's) listed in the American markets.

2. Literature review

Literature on corporate governance mentions two internal control mechanisms: the board of directors and the equity ownership structure in each company (Denis and McConnell, 2003).

Research on boards of directors has focused on two important aspects, the boards' composition and how compensation is determined. Hermalin and Weisbach (2002) analyzed on literature that reviewed the composition and characteristics of boards of directors. Based on their results, the most widely studied characteristic has been the relationship of the prevailing ratio of the number of outside directors to the total number of board members and the financial performance of the company. The study arrived at three specific conclusions. First, having more outside directors on the boards is not related to better development in the company, but is related to better decision making regarding purchase acquisitions, determination of compensation levels for executives, or the election of a CEO. Second, the size of the boards is associated with bad financial performance of the company and unfortunate decision making. The bigger the board, the worse the performance and decision making will

be. Third, the more the board members are changed, the worse the financial performance of the company will be, along with its decision making.

Research on the characteristics of the boards has been done in other countries. Kaplan and Minton (1994) reviewed the effectiveness of boards in Japan. Blasi and Shleifer (1996) examined the structure of boards in Russia, whereas Wymeersch (1998) reviewed the way boards are comprised in Europe, and called attention to the fact that the role of the boards was not determined by many European laws. Rodríguez and Anson (2001) studied the effectiveness of boards in Spain.

Another important point is whether the CEO and chairman positions should be held by the same person. According to Denis and McConnell (2003), little or limited evidence exists to indicate that it will mean a better performance for the firm.

As for decisions on compensation, little has been studied outside the US. Core, Guay, and Larcker (2001) did a survey using data from American companies. The results showed that payment sensitivity and the performance of the firms have both increased with time in the US. The researchers also point out that this sensitivity was the result of the alignment of compensation plans with the performance of the company, such as the options over share purchase, and these compensation plans were amongst the most popular and had the highest growth rate in the US.

Ownership structure and its concentration are the most widely studied topics in the world, thus the most extensive. Research has focused on different topics applied to different economies. According to La Porta et al. (1999), equity concentration is common in those economies that offer relatively lower protection to private property than in those in which property is protected. Faccio and Lang (2002) studied company ownership in Western Europe and considered that companies with higher levels of equity concentration are countries other than England and Ireland. For Latin America,

Valdares and Leal (2000) documented a high concentration of ownership in companies listed in the Brazilian stock market. This equity concentration occurs primarily in blockholders and individuals.

The way in which property is concentrated can vary. The main mechanisms of stock control are dual-class shares, pyramiding, and cross-holdings. Studies done on dual class stocks state that, voting shares list higher prices than non-voting shares. This effect is known as private benefits of control. Research support the effect of private benefits of control has been done by Lease et al. (1984), DeAngelo and DeAngelo, and DeAngelo (1985), and Zingales (1995). As for pyramiding, Alemida and Wolfenzon (2006) offered a theory that explained the incentives to take control of the company through pyramiding when property protection was low in the economy. Faccio and Lang (2002) reported the use of dual class shares and pyramiding as the most widely used methods of equity concentration and control in Europe.

One conclusion about ownership structure is it concentrates more in countries other than the US and England. The structure of ownership and its concentration have a higher impact on non-American companies. This fact demonstrates that concentration of property has positive effects on the performance of companies. A final conclusion states that private benefits of control surpass the benefits for preferred shares in a global context.

Little has been researched on corporate governance in Mexican companies. The studies available were done at an aggregated level and derived few details on the companies. La Porta and López-de-Silanes (1997) studied the benefits for companies going private in Mexico. The study uses a sample of 218 non-financial companies that were privatized between 1983 and 1991. The result was that the prices of companies were positively correlated to the presence of foreign investment and the change of

CEO's. Pinegar and Ravichandran (2003) examined companies that had ADR's for each of the two kinds of common stocks with different rights. Out of the ten pairs of shares studied, the ADR's of the five pairs of Mexican companies were handled on a discount basis (reinvestment discount). The authors concluded this was because firms in Mexico changed their structure of capital to debt.

Dubkovsky and García (2002) analyzed the Mexican firms that joint ventured, merged, or were taken over by foreign companies, and the positive abnormal returns for those companies related to those kinds of investment. They found this situation was a result of deregulation derived from NAFTA, since investors had a better perception of returns in companies. Perhaps the most closely related study on corporate governance and ownership structure in Mexico was the one published by Husted and Serrano (2002). The research analyzed, in a very general way, the development of the model of corporate governance in Mexico. The authors reviewed the factors that shaped the model in the last 25 years and, lastly analyzed the consequences of changes in the models of corporate governance for macroeconomic development.

Despite all of these studies, an in-depth description of the two main internal mechanism of corporate control in Mexican companies had not been done before.

3. Data base and sample

For this research, information has been gathered from non-financial companies listed in the capital market of the BMV. The samples are for years 1996, 2000, and 2005. The data base is formed by three types of information: information

on financial performance, information on ownership, and information on boards of directors.

The information on financial operations or performance includes data from corporate financial statements. The data was found in the annual balance sheet, income statement, the statement of changes in capital, and cash flows of each company. Information is provided on an annual basis and is given in constant Mexican pesos for December 2005. For companies that represent conglomerates and whose subsidiaries are also listed in the capital market of the BMV, the financial information was considered without those subsidiaries, aiming to avoid duplication of figures presented in the analysis. The sources of information are diverse. For the integration of the corporate information, data was obtained from the annual financial reports provided by companies. Information on the electronic data base Economatica was also used. Other electronic data bases of the BMV were used, as well as some other available at the World Federation of Exchanges. The process sought to verify the data from the two primary sources.

The information on structure of ownership includes the name of the voting shareholder in the company, and the percentage of stocks he/she owns. It is important to note that this information includes only information on voting shares. Restricted (limited) or preferred stocks are not included in the data set. Information is annual and was recorded on the date of the annual ordinary meeting of stockholders of the company under study. The rationale in this case is as follows: on the day of the annual ordinary meeting, shareholders have to vote on approving the financial statement for the previous period, and elect the board that will make important operative decisions during the upcoming year. This means the information is available "a-priori". Hence,

the data on stocks is found on the date of the ordinary annual meeting that took place in April 1996, 2000 and 2005 for each company.

Four kinds of companies can be found in the data set, categorized according to stock participation: family businesses, subsidiaries of domestic companies, subsidiaries of foreign companies, and unidentified-owner companies²⁴. When the main shareholders of a company are members of a family, I summed up all the fractions the members held and considered the company to be a family business. I applied the same rule when a majority holder held a high percentage of shares and his/her children or relatives were small stockholders. Mexican companies represent the subsidiaries of domestic companies that are listed in the BMV. The subsidiaries reported that their main stockholder was a Mexican company. However, that company is private and is not listed in the capital market, hence we do not know its ownership structure. When a company is owned by a foreign corporation, whether it is listed or not in its domestic stock market, the category of subsidiary of a foreign company is ascribed. Unidentified-owner company is one that had no majority holder identified, since most of the shares were owned by the market. In this last case, I reported the fraction of shares owned by the market.

The ownership of companies was considered to avoid the pyramiding effect in the case of subsidiaries. This means that if company A has 40% of equities of company B, and the shareholder X has 50% of equities of company A, then shareholder X has 20% of equities of company B²⁵.

Different sources were used to gather the ownership information of the companies. The main source was the acts from ordinary annual meetings. This source

²⁴ Some companies are owned by the Mexican government. However, the number of companies is small and some of them were privatized during the period studied. Companies owned by the government are those where the main stockholder is a government office in Mexico, either a ministry, body or commission.

²⁵ Studies on pyramiding like Faccio et al. (2002) consider these procedures.

was chosen because those meetings are restricted to voting shareholders in the company. The agenda is included with each act, as well as the decisions made and the names of those who attended the meeting, the amount of stocks owned by each and the percentage each represents in the total. It is worth mentioning that there is the possibility of a shareholder being absent from the annual meeting. In this event, a representative can be assigned. This situation represented a problem for the generation of the data base, since in those cases the name of the stockholder was not given, but instead, the name of the representative was substituted. To solve the problems associated with this situation, I used the electronic data base of the depository company (INDEVAL). This data base provides information on stockholders of record for the date of the ordinary annual meeting. The disadvantage of using the electronic records of INDEVAL is that, given the stock activity, a share can have several different owners on a given day. In this case, I looked for the name of the holder in alternate sources, such as the minutes of extraordinary annual meetings, the annual financial reports of the company, the electronic reports of the BMV, and the information included in Lexis – Nexis. When the name could not be identified with precision, the note “Gran público inversionista” was used, noting that the stocks are owned by the market. This was the case for the unidentified-owner companies. It is also important to mention the cases of stock buyback and stocks previously bought by the company. In both situations, those stocks were deducted from the total, since they were already owned by the company²⁶.

Information on the boards of directors includes the names of the members of the boards in companies, the positions they held, and information on whether they

²⁶ The LMV declared on December 30, 2005 that companies can buy their own stocks and that doing so does not mean a reduction in the total of stocks. However, since stocks used to be deducted before that date, this last criterion was applied.

were independent directors or not²⁷. Data is provided for the date of the companies' ordinary annual meeting. To build this data base, only the information in the minutes of the ordinary annual meeting of stockholders was used, since the official information could be found there, signed by those who attended the meeting.

The sources of information used, as well as the data base, are summarized in table 6.

[Insert Table 6 about here]

The information on the number of companies that build the sample for this data can be found in table 7.

[Insert Table 7 about here]

4. Corporate governance, ownership, and the size of the companies

The first analysis takes into account the size of the companies, measured by the amount of assets they had. Figure 5 presents information about the companies in the sample and the fraction of the total amount of assets in the market that they held each year.

[Insert Figure 5 about here]

The figure reports more than 85% of the total assets of the companies in the Mexican market were held by few companies. Based on this data I created two groups of companies: the 30 largest corporations, and the small companies. The decision to 30 companies was arbitrary; the patterns of the fraction of total assets held by the Mexican companies were similar.

²⁷ The companies used the definition for independent director provided by the LMV.

Table 8 describes the situation of two groups of companies: the group of 30 largest companies and the group of small companies. The groups were formed according to the total assets the companies held during those years studied. Table 8 presents information regarding their financial transactions and the characteristics of their corporate governance.

[Insert Table 8 about here]

Panel A of table 8 shows the operating information integrated using three indicators: the average (median) of total assets; the average (median) of leverage; and the average (median) of the financial performance measured by the Market-to-book (M/B) ratio for each group of companies. Figures are in Mexican pesos, based on December 2005 data.

In general, it can be stated that the 30 largest companies grew as far as the number of assets owned. This was also true for companies in the group of small firms. However, the group of the 30 largest companies presented better performances in the market. The group of small companies had higher leverage and these companies grew in three years. This trend may show that these kinds of companies had turned to other sources of financing instead of capital markets.

The group of the 30 largest companies owned assets totaling an average of 48.31 billion Mexican pesos in 1996, 64.89 billion in 2000 and up to 81.61 billion Mexican pesos in 2005. Their levels of leverage were 47.27% in 1996, 54.10% in 2000, and a high of 52.24% in 2005. The M/B indicator for the 30 largest companies registered was, on average, 156.32% in 1996, 131.34% in 2000, and 240.00% in 2005. As for the group of small companies, their total assets reached 4.10 billion Mexican pesos in 1996, and 4.80 billion in 2000. In 2005, they registered 5.70 billion pesos, on average. As for leverage, the range was 44.81% in 1996; it increased to

59.66% in 2000, and reached 70.69% in 2005. The M/B indicator of financial performance for companies in the group of small firms registered levels of 93.20% in 1996, 73.77% in 2000, and reached a high of 104.15% in 2005.

Panel B in table 8 describes the composition of the boards in companies for both groups. The description includes four indicators: the number of members of the board is built by the average (median) of the number of directors per board. The second indicator is the average (median) fraction of independent directors by board. The third indicator is the counterpart of the second indicator, since it represents the average (median) percentage of non-independent director per board. The last indicator is the fraction of companies with the same individual serving as both chairman of the board and CEO. Figure 6 shows the evolution observed from 1996 to 2005 in the building of boards for both groups of companies, and also, the evolution of the percentage of independent advisors for each group of companies.

[Insert Figure 6 about here]

It can be observed that the group of the 30 largest companies had boards that were a little bigger than those of the small companies, with an average difference of two members per board. There was also stability in the composition; this means that the numbers were almost constant in the three years used for this study. During the years studied the chairman of a small company most commonly held the position of CEO.

As for the average number of directors on each board, the groups of the 30 largest companies had 14.88 board members in 1996, 14.82 in 2000, and up to 15 in 2005. The fraction of independent directors for the 30 largest companies was 34.21% in 1996, 37.24% in 2000, and increased to 36.75% in 2005. The small companies group had an average of 11.34 members of the board in 1996, 11.94 in 2000, and by

2005, the number increased to 13.54 directors on the board. The fraction of independent directors for the small companies group reached 27.01% in 1996, 32.22% in 2000, and increased to 32.86% in 2005. In 1996, 29.77% of the 30 largest companies reported the positions of chairmen of the board and CEO were occupied by the same individuals. This percentage reached 26.67% in 2000 and 25.33% in 2005. In 1996, 45.77% of the small companies reported this same situation; In 2000, the percentage dropped to 44.45, and finally, fell to 43.33% in 2005.

Panel C of table 8 describes the level of activity of directors of the boards for both groups. These levels of activity are related to more information, since they are expressed by three indicators. The first is the average (median) of the number of directors with at least one outside appointment on the board of another company. The second is the average (median) of the total number of outside appointments in every board from all the companies that form each group. If this figure is large, the board was very busy. The third indicator is the average (median) of the number of interlocks per board in each group. If this indicator is high, the board had more information on transactions of other companies.

We can see that the group of the 30 largest companies was more active and handled more information than the group of smaller companies, since the three indicators presented larger figures for the group of the largest companies.

As for the indicator of directors with outside appointments, I found that the group of the 30 largest companies had 2.88 outside appointments per director on average in 1996, and the number increased to 3.52 in 2000, by 2005 it decreased to 2.67 directors who held at least one position on the board of another company. The group of the 30 largest companies had an average of 16.63 outside appointments on their boards in 1996; this number increased to 26.26 in 2000, and decreased to 18.12

in 2005. As for the number of interlocks by board, the positions increased to 1.76 in 1996, 2.23 in 2000, and in 2005, fell to 2.22. The group of small companies had an average of 1.74 directors with an outside appointment in 1996, 2.01 in 2000, and increased in 2005 to 1.28 directors per board with at least one position on the board of another company. The total of outside appointments by board for small companies was 5.85 in 1996, 9.02 in 2000, and 5.15 in 2005. The group of small companies registered an average interlock indicator of 0.41 in 1996, 0.43 in 2000, and increased to 0.47 in 2005.

The analysis of ownership for both groups of companies is presented in table 9.

[Insert Table 9 about here]

Table 9 classifies the groups of stockholders into four broader subgroups. The first includes family businesses, where the main stockholders (in the group) are members of a family, or there is one majority holder. The second subgroup is Mexican companies, where the majority shareholder is a private company of Mexico. Foreign companies make up the third subgroup, where the corporations were subsidiaries of foreign companies. The fourth subgroup includes unidentified-owner companies, where no owner is identified the largest amount of shares are in the market. Panel A presents the number of companies for each type of majority shareholder. Panel B of table 9 shows the percentage of stocks owned by the majority stockholder. As we see in panel A, no matter the group, most companies are owned by families. The number of family businesses in the group of the 30 largest companies was 18 in 1996, and 20 for 2000 and 2005. However, the percentage of ownership is, in every case, below to 50%. The percentages of stocks that a family controlled was, on average, 42.77 in 1996, 38.50 in 2000, and 33.69 in 2005. The number of Mexican

subsidiary companies in the group of the 30 largest was 4 in 1996, 6 in 2000, and 7 in 2005. The percentages of ownership that Mexican companies required to control those subsidiaries were 27.58 in 1996, 29.71 in 2000, and 33.12 in 2005. As for foreign subsidiary companies in the 30 largest companies group, the number was 3 in 1996, 2 in 2000, and 2 in 2005. The percentages of stocks that foreign companies required to control those subsidiaries in Mexico were 17.36 in 1996, 26.05 in 2000, and 44.00 in 2005. As for small companies, family businesses added up to 47 in 1996, 46 in 2000, and 47 in 2006. The average percentages of stocks needed to control a family business were 31.53 in 1996, 30.82 in 2000, and 42.44 in 2005. The number of Mexican subsidiary companies in the small companies group was 15 in 1996, 17 in 2000, and 14 in 2005. The percentages of stocks owned by Mexican companies to control their subsidiaries were 36.51 in 1996, 38.25 in 2000, and reached 49.13 in 2005. The number of foreign subsidiaries in this sample was 9 in 1996, 11 in 2000 and 7 in 2005. The percentages of stocks owned by foreign companies to control their subsidiaries were 30.32 in 1996, and 25.45 in 2000; this percentage increased to 33.65 in 2005.

Panel C in table 9 analyzes the ownership held by the board and the CEO for each group of companies. The first indicator shows the fraction of companies in each group where the board owned 50% of stocks or more. The second indicator shows the fraction of companies where the CEO was a shareholder in the company. We can see that in general, the group of small companies tended to have boards where directors owned most of the stocks. Additionally, it can be noted that most of the time, the CEO in those small companies was a stockholder; this could be because of in this type of firm the CEO was also the majority shareholder.

The fraction of firms in the small companies group with boards whose directors owned at least 50% of stocks was 63.33% in 1996, 66.67% in 2000, and 67.74% in 2005. The percentages of companies in the group of small corporations where the CEO was a shareholder was as follows: 56.67 in 1996, 53.34 in 2000, and 54.84 in 2005. The fraction of firms in the group of the 30 largest companies with boards whose directors owned, together, at least 50% of the total of stocks was 43% in 1996, 42.45% in 2000, and 63.63% in 2005. The percentages of companies in the group of the 30 largest companies where the CEO was a shareholder were: 32.00 in 1996, 31.13 in 2000, and 50.00 in 2005.

Table 10 describes in detail family businesses in each group of companies. This table shows how many members of the family, on average, owned stocks of the company, and what average of the percentage of stocks owned by the family were owned by the majority stockholder from the family.

[Insert Table 10 about here]

We can see that the difference between the two groups is important. On the one hand, the fraction held by the family in the 30 largest companies group diminished during the years studied. In the other hand, the same percentage increased in the small companies group. However, the average number of family members who owned stocks in both groups was not really high, and it can be observed that stocks were distributed in a relatively equal way.

The group of the 30 largest companies shows the average number of members with voting stocks in family owned businesses was 2.61 for 1996, 2.65 for 2000, and 2.60 for 2005. The percentage of stocks owned by the majority stockholder who was a member of the family was 17.56 of the total owned by the whole family in 1996, 14.25% in 2000, and 10.84% in 2005. For the small companies group, the

average number of family members with stocks was 2.12 in 1996, 2 in 2000, and 2 in 2005. The percentage of stocks owned by the majority stockholder who was a member of the family was 9.94% in 1996, 9.50% in 2000, and 17.73% in 2005. However, the median of the percentages for this group were 29.58 in 1996, 30.19 in 2000, and in 2005 reached, 40.70. Thus, a substantial number of small companies had owners who held a large portion of the companies' shares.

In general, it is observed that the 30 largest companies presented a better financial performance in terms of their M/B ratio. These types of companies accumulated more assets during the period studied and they did not increase their leverage as much as the companies of the small group did. Their better performance may be related to better decisions made during these years and could also be supported by the fact that the group of the 30 largest companies separated the positions of CEO and chairman of the board more frequently than their smaller counterparts. The group of large companies had more active boards and we can assume that these boards handled more information.

5. Corporate governance, ownership, and cross-listing

5.1 Corporations with ADR's listed in American markets

The following analysis of the internal mechanisms that determine corporate control in Mexican companies was done bearing cross-listing in mind. To do so, the sample of companies was divided into those companies with American Depositary Receipts (ADR's) listed in American financial markets, and those companies listed only in the domestic market. This analysis did not take into account the type of ADR

or the type of the underlying security. Table 11 shows the relation between the number of companies with ADR's and the companies without ADR's, as well as the size of the companies, according to the number of assets they owned. The relationship is expressed in percentages and the information in parentheses shows the number of companies represented.

[Insert Table 11 about here]

The description identifies two groups: The ADR's group is the set of companies listed in American markets for the years studied; the Non-ADR's group includes the companies that did not list securities in those markets during the same time period.

Table 12 describes the situation for both groups of companies regarding their financial operations and the characteristics of their corporate governance.

[Insert Table 12 about here]

Panel A shows the operative information using three different indicators. The average (median) of the total of assets; the second shows the average (median) of total leverage in the companies, related to their total assets. The third is the average (median) of the financial performance indicator Market-to-book (M/B) for each group of companies. The figures are in Mexican pesos based on December, 2005 data.

In general, it can be observed that the amount of assets for both groups grew during the three years studied. The ADR's companies owned more assets than the Non-ADR's companies. Additionally, the performance of the market measured by the M/B indicator was much better for the ADR's. This observation is supported by international research on companies that own stocks in foreign markets. An important point is the fact that in both groups of companies, leverage is high; in some years it surpasses 50% of their capital structure. Companies in the Non-ADR's group had

higher leverage than companies in the ADR's group. Furthermore, leverage increased in the three years used for this study

The ADR's companies had a total average of assets of 29.30 billion Mexican pesos in 1996, 35.39 billion pesos in 2000, and 52.50 billion pesos in 2005. The ADR's group of companies showed leveraged of 38.70% in 1996, 51.64% in 2000, and 56% in 2005. The financial performance of the ADR's group had high numbers, with a 166.50% average in 1996, 147.60% in 2000, and 207.20% in 2005. In the case of Non-ADR's companies, the average of stocks was 11.08 billion Mexican pesos in 1996; this indicator went up to 13.36 billion pesos in 2000, and reached 16.37 billion in 2005. Leverage was 46.82% in 1996, 60.27% in 2000, and 69.22% in 2005. The average financial performance in the group of Non-ADR's placed the M/B indicator at 95.14% in 1996, 69.91% in 2000 and 116.74% in 2005.

Panel B in table 12 describes the composition of the boards of companies for both groups. This description uses four indicators. The first shows the average number (median) of directors per board. The second indicator shows the average (median) percentage of independent directors of the boards. The third indicator is the counterpart of the second indicator, because it represents the average percentage of non-independent directors on the board. The last indicator of panel B presents the fraction of firms, per group, whose chairmen of the boards also held the position of CEO. Figure 7 shows the evolution observed from 1996 to 2005 of the average number of members per board for companies in both the ADR's and Non-ADR's groups. The figures also illustrate evolution of the fraction of independent advisors for each group of companies.

{Insert Figure 7 about here}

Both table 12 and figure 7 show the difference between the two groups of companies. The ADR's group demonstrates a tendency to have a slightly larger number of board members than the Non-ADR's group. This difference, however, amounts to only approximately one additional member. The same situation occurs with the percentage of independent members of the board. One prominent difference is that on average, 25% of companies in the ADR's group had the same individual holding both position of CEO and chairman of the board. In the case of the Non-ADR's companies this fraction was 47%. ADR's companies tended to separate these positions during the years studied.

ADR's companies added as many as 12.95 members, on average, to their boards in 1996. The number increased to 13.85 members in 2000, and went up to 14.89 in 2005. The fraction of independent directors for this group was 29.24% for the 1996 boards, 37.35% in 2000, and 36.88% in 2005. In the case of the Non-ADR's group, the average number of members per board was 12.01 in 1996, 12.26 in 2000, and 13.61 in 2005. The fraction of independent advisors for these kinds of companies was 28.63% in 1996, 32.33% in 2000, and 32.91% in 2005. In 1996, 25.25% of the companies in the ADR's group had chairmen who were also appointed as CEO's. By 2000, this percentage was 25.01 and it reached 25.00 in 2005. For the Non-ADR's group, the percentages were 47.44 in 1996, 47.00 in 2000, and 46.34 in 2005.

Panel C in table 2.8 describes the levels of activity of members of the boards for both groups of companies. These levels of activity were related to access to more information, are expressed using three indicators. The first indicator is the average (median) of the number of directors who held an outside appointment on the board of another company. The second indicator shows the average (median) of the number of outside appointments the boards had in companies that comprised each group. If this

number is high, board was busy. The third indicator is the average (median) of the number of interlocks by board in each group of companies. If this number is high, the board had more information on what was happening in other companies.

Boards of directors are more active in ADR's companies, so it can be assumed they handled much more information than their counterparts in the non-ADRs companies. For the ADR's group, the number of directors with outside appointments was 3.78 in 1996, 5.03 in 2000, and 4.16 in 2005. These numbers are higher in the Non-ADR's group, which reported 2.30 directors with outside appointments in 1996, 3.50 in 2000, and 2.87 in 2005. The total number of outside appointments by board in the ADR's group in 1996 was 12.17, in 2000 it was 17, and in 2005 it fell to 11.80. These numbers were also higher for the non-ADR's group, which accounted for 7.51 outside appointments by board in 1996, 11.70 in 2000, and 7.43 in 2005. Perhaps the most dramatic case is the interlock by board, because ADR's companies had an indicator of 1.26 interlocks in 1996, 1.58 in 2000, and 1.53 in 2005, whereas non-ADR companies reached 0.60 interlocks in 1996, 0.62 in 2000, and 0.73 in 2005.

Table 13 shows the analysis of ownership for ADR and non-ADR companies.

[Insert Table 13 about here]

Panel A classifies the groups of stockholders into four subgroups. The first subgroup includes businesses where the main shareholders were members of one family or where the company had only one majority shareholder. The second subgroup is Mexican subsidiaries, companies whose majority stockholder was a private Mexican company. The third subgroup foreign subsidiaries, includes companies whose largest shareholder was a foreign corporation that may or may not

have been listed in its domestic financial markets. Finally, the fourth subgroup is unidentified-owner companies that did not have a single identified majority stockholder. The table shows the number of companies per type of shareholder and the stock percentage the shareholder held to control the company.

As we observe the panel we can notice that regardless of the group we refer to, most companies were family owned businesses. By 2005, families with control over ADR's companies owned an average of 37.03% of the voting stocks of their companies. Furthermore, we can see that Mexican groups with companies listed in the BMV had control over their subsidiaries with 53.70% of the voting shares in 2005. Foreign companies had control over their subsidiaries in Mexico with 44.00% in 2005. In the case of non-ADR companies, most of the firms were family businesses, with families keeping control of the company with 40.71% ownership of stocks in 2005. Mexican companies with subsidiaries listed in the BMV that were Non-ADR's had 39.83% ownership in 2005, whereas foreign companies had control over their subsidiaries with 33.65% of voting stocks in 2005. In all cases of non-ADR companies, we observe a growing tendency toward equity concentration.

The analysis of ownership of members of the boards and the CEOs for each group of companies is found in panel C of table 13. The first indicator shows the fraction of companies in each group in which the board owned 50% or more of the stocks. The second indicator points to the fraction of firms in each group of companies where the CEO was a stockholder.

The description of this table shows that companies in the Non-ADR's group tended to have members of the boards more involved with the ownership of the companies compared to members of boards of ADR's companies. Moreover, the table

shows there were more cases where the CEO was a stockholder in Non-ADR's companies throughout time.

The group of Non- ADR's companies shows the fractions of companies where the boards had more than 50% of voting stocks were 60.87% in 1996, 62.07% in 2000 and up to 66.67% in 2005. The fraction of companies in the same Non-ADR's group with a CEO who was also a stockholder was 47.83% in 1996, 44.83% in 2000, and 46.67% in 2005. The numbers for ADR's companies regarding the fractions of firms where the members of the boards of directors owned more than 50% of the voting stocks was 44.86% for 1996, 43.93% in 2000, and 64.04% in 2005. The percentages of ADR's companies where the CEO's were a stockholder were 35.51 in 1996, 33.64 in 2000, and 32.81 in 2005.

Table 14 describes in detail family businesses for companies with and without ADR's. This table shows how many members of a family, on average, owned stocks in the company and the average percentage of those shares that were owned by the majority stockholder in the family.

[Insert Table 14 about here]

I find that the differences between both groups of companies are not really representative in terms of the percentage of voting shares held by families. The average number of family members who owned shares was not high. However, the percentage of shares held by the largest shareholder of the family was different between the two groups. The largest shareholder in the family for a corporation in the ADR group held 12.46% of the voting shares in 1996. This percentage rose to 13.71 in 2005. Meanwhile, in the Non-ADR's group, the largest shareholder in the family controlled 32.22% of the voting shares. The percentage reached 33.12 in 2005.

This description suggests that Mexican corporations included in the ADR's group tended to hold more assets than their Non-ADR's peers. The performance of the ADR's group was better during the three years studied and the leverage was small. The ADR's group had more active boards and their CEO's and the chairmen of the boards were different individuals. This evidence may suggest that the corporations that held ADRs in the American markets had better performance because their boards had more information, more activity and more independence.

5.2 Corporations with ADR's in American markets and the size of their assets

Figure 8 presents the evolution of financial performance by company groups.

[Insert Figure 8 about here]

This figure suggests that the companies with better financial performance tended to hold more assets and held ADR's. I chose this method of analysis to have a more complete description of the situation in companies that had securities listed in American financial markets. In this analysis only companies with ADR's were taken into account and divided into two groups. The first group is formed by companies with ADR's that had large amounts of assets and the second group is integrated by companies with ADR's that held small amount of assets. For the classification, I chose companies from the group of the 30 largest companies from the first analysis of this paper, and considered only those with ADR's listed during the years under study. I did the same for the group of small companies.

Table 15 describes the situation in both groups of ADR's companies, large and small, regarding their financial performance and the characteristics of their corporate governance.

[Insert Table 15 about here]

I repeated the same analysis using the large ADR's and small ADR's companies.

Panel A shows operative information, the same as in the previous analysis. The panel uses three indicators: the average (median) of the total of assets, the average (median) of total leverage of companies related to the market value of their assets, and the average (median) of the financial performance indicator Market-to-book (M/B) ratio for each group of companies. Figures are expressed in Mexican pesos based on December 2005 data.

Large companies with ADR's had between seven and nine times more assets than their counterparts in small companies. Additionally, large companies with ADR's had more leverage than the small ones; those had higher growth of leverage. The financial performance for the group of large companies with ADR's was the most outstanding of all in this study's analysis.

As for the total of assets, large ADR's companies accumulated 60.17 billion Mexican pesos, on average, in 1996; this figure was 56.46 billion pesos in 2000, and rose to 93.59 billion in 2005. Leverage remained close to constant at more than 50% throughout the three years period, and held figures close to constant at 57.41% in 1996, 57.02% in 2000, and 56.59% in 2005. The M/B financial performance indicator for the group of large ADR's companies accounted for 193.29% in 1996, 151.90% in 2000, and climbed to 303.33% in 2005. As for the group of small ADR's companies, the total of assets was 9.46 billion Mexican pesos in 1996; by 2000 the figure rose to 9.47 billion pesos, on average, and in 2005 it reached 11.42 billion. Leverage in small ADR's companies was 26.67% in 1996, 45.02% in 2000, and ended up at 55.06% in

2005. The financial performance M/B indicator reached 149.29% in 1996 and dropped down to 111.06% in 2005.

In panel B of table 15, I give the characteristics of the boards of directors. Large ADR's companies tended to have more members on their boards during these years than their small ADR's peers. For large ADR's companies, the average number of members of the boards was 14.33 in 1996, with 37.51% independent members. By 2005, the figure climbed to an average of 15.46 members on the boards with 39.48% independent members. As for the small ADR's companies, the average number of members on the boards was 11.91; 23.03% were independent members. By 2005, small ADR's companies increased the average number of members of their boards, reaching an average of 14.28 with 33.6% of them being independent members. The percentage of companies in the large ADR group that had the same individual holding both positions of CEO and chairman of the board were very similar to their peers in the small group. The companies of the large ADR's group that were in this situation reached 25.05% in 1996. By the year 2005, 25.84% of the companies had the positions of CEO and chairman of the board occupied by the same individual. In the case of the small ADR's companies, the corresponding percentages were 27.45 in 1996, 28.67 in 2000, and 29.55 in 2005.

Perhaps the most significant difference regarding members of the board was the activity of the boards. I analyze this in panel C table 15. In this panel we can see that large ADR's companies had 3.33 directors who held outside appointments in 1996. By 2000, the figure was 3.50 and in 2005, it rose to 2.78. In 1996, small ADR's companies had 2.16 members of their boards who held outside appointments. By 2005 the average number of members of the boards in this situation was 1.61.

Furthermore, the group of large ADR's companies had a greater number of interlocks. In 1996 this indicator was around 1.88, and went up to 2.40 by 2005. Small ADR's companies had 0.85 interlocks in 1996 and only 0.66 by 2005.

Table 16 shows who had stock control within ADR companies. The table examines four subgroups of companies according to ownership: family businesses, Mexican subsidiaries, foreign subsidiaries, and unidentified-owner companies.

[Insert Table 16 about here]

Panel A of table 16 indicates the number of companies within each subgroup. Once again, it confirmed that the largest fraction of the companies were family owned. Mexican subsidiaries represented in the category of Mexican companies were more common in the small ADR's company group. Panel B presents the percentage of the voting shares that the largest shareholder had within each company subgroup. Additionally, table 16 shows in panel C the extent to which the boards of directors were involved, and it indicates the percentage of companies in which members of the boards owned more than 50% of the stocks of the companies. Panel B also shows the percentage of companies where the CEO was a shareholder.

In 1996, large ADR's companies were controlled by families that were majority shareholders with 38.53% of stocks. By 2005, that percentage was reduced to 26.89. In the Mexican companies' subgroup, control was held with 20.34% of shares in 1996. Yet, by 2005 this percentage doubled, reaching 47.29. Large Mexican ADR's companies whose major holder was a foreign company were controlled with 52.10% of stocks in 1996. By 2005, the percentage went down to 44.00.

Families who had control over small ADR's companies had 32.53% of the total shares in 1996. This percentage increased to 50.08 in 2005. A growth standard was observed in the equity concentration of subsidiary firms of Mexican companies.

In 1996, the stocks of the majority holders represented 57.13%, and in 2005 their stock represented 60.12%.

Panel C shows that large ADR's companies with boards that owned more than 50% of stocks represented 77.78% of the sample in 1996. By 2000, the percentage fell to 68.75 and by 2005, the figure decreased to 66.67%. Small ADR's companies with boards that owned more than 50% of stocks in 1996 made up 50% of the sample. By 2005, the percentage increased to 66.67. The panel shows that the fraction of large ADR companies with CEO's who were shareholders was 66.67% in 1996, 50% in 2000 and 46.67% in 2005. The same indicator for small ADR's companies reported 35.71% in 1996, 38.46% in 2000, and 46.67% in 2005.

Table 17 analyzes the equity concentration of family businesses with ADR's. It can be stated that, on average, three members of the family controlled the company and the shares were distributed among the family on an almost equal basis.

[Insert Table 17 about here]

For the case of large ADR's companies, the average number of family members with shares was 3.33 in 1996, 3.18 in 2000, and 2.88 in 2005. The majority holders in the families owned an average of 14.85% of the total of shares of the companies, and this percentage fell to 7.23 in 2005. In the case of small companies, the average number of members of the families with stock control was 2.71 members in 1996, 2.20 in 2000, and 2.85 members in 2005. The equity ownership percentage of the majority holders in the families was 10.58% in 1996, 15.71% in 2000, and 25.82% in 2005.

This analysis indicates that the large ADR's companies exhibited the most prominent performance in the Mexican market during the years studied. Their levels of total assets and M/B ratio outreached other groups' indicators. The activity of the

boards of directors of the large ADR's companies was prominent, also, and this fact may support the argument that information gained from other boards could translate into better decision making for the companies.

Chapter Three

Conclusions

The motivation for this research is to explain and describe the mechanisms that discipline corporate governance in Mexican companies. The financial market in Mexico is 150 years old. The market is the oldest in Latin America and the second largest in terms of market capitalization. The average years of companies is 50 years old and during the period of time studied, the companies waited 30 years on average to go public.

The economic environment, in which the Mexican companies grew and developed, has changed across time. The changes occur because of the diverse economic paths taken by the federal government of Mexico during different time periods. Prominent studies divide the modern economic history of Mexico into six periods. Each one of these periods is related to economic programs and the political situations experienced by Mexico during that time frame. During each period, companies generated internal mechanisms of corporate control to respond to changes in the economic environment.

In general, Mexican corporations currently traded on the financial markets have developed their mechanisms of corporate control to protect the ownership from two major threats: nationalization processes and takeovers. The mechanisms these companies have used are dual-class shares, pyramiding, cross-holdings and the use of financial resources from internal capital markets. However, for almost a quarter of a century, Mexican corporations enjoyed the benefits of a protected domestic market. In the recent years, Mexico implemented one of the most extensive programs of privatization in the world. This fact, along with increasing international free trade

agreements and increasing foreign investments brought the necessity of changes in regulatory policies related to corporate governance in Mexican corporations.

The legal / regulatory system is another external mechanism that disciplines the corporate control in companies. The Mexican legal system is based on the French law or Napoleonic Code. According to previous studies on corporate governance and law, this system offers limited protection to private property. However, corporate governance regulations are similar to the American policies in many ways. In Mexico, the regulation of corporate governance is overseen by two laws: the general mercantile societies law (LGSM) and the stock market law (LMV).

The incorporation of a company can take place in any Mexican state. The shareholders' meeting is the ultimate body of corporate control in a Mexican corporation. In corporations, the board of directors is the collegiate body in charge of the corporate governance of the company. The major decisions affecting the life of the company are made in these meetings. In Mexico, the board has the following functions: to hire, evaluate, and fire top management. The board must be composed of no more than 21 directors. Directors can be independent or non-independent. The board of directors must be formed by at least 25% of independent directors. The shareholders who own 10% of the voting-shares have the right to name one director. The term of a director is a company matter, however, the common practice is to have a one-year term for each director, with reelection allowed. Staggered terms are rare in Mexican companies.

Minority rights recommended by OECD are covered by the Mexican laws and regulations. The LMV forces public companies to have at least two committees: the audit committee and the best-practices committee.

The Chief Executive Officer is the person in charge of direct management in a company. According to Mexican law, the CEO's functions are to run the company's operations and perform day-to-day management, propose business strategies to the board of directors, prepare financial information, and be responsible for maintaining the company's diverse systems.

The analysis of the financial performance of non-financial public companies concludes that financial markets in Mexico are concentrated. In the years studied, only 30 corporations controlled more than 85% of the total assets in this market. Most of the companies are family owned, and, on average, three family members control the voting shares of the entire company.

The study reveals that in general, Mexican companies tended to have bigger boards of directors than their American peers. The percentage of companies in which the positions of CEO and chairman was occupied by the same individual is less than the percentage in American corporations.

The 30 largest companies in the Mexican market presented a better financial performance and tended to have bigger boards of directors with more outside activity during the years studied. The separation of functions between the chairman and CEO was common in the 30 largest companies. Small companies tended to have boards formed by directors who had at least 50% of the voting shares and the CEO was a shareholder in more than a half of them.

The Mexican companies that had American Depositary Receipts (ADR's) displayed an outstanding financial performance, also. These companies had more active boards, and as the 30 largest companies, demonstrated separation of functions between the chairman and CEO. The companies without ADR's as well as the small

companies tended to have boards formed by directors who had at least 50% of the voting shares and the CEO was a shareholder in more than a half of them.

The most relevant financial performance is reported by the companies that had ADR's and belonged to the 30 largest companies group. Once again, the activity reported by the boards from these companies was significant. It is worthwhile to mention that the large corporations with ADR's tended to have boards integrated by directors who held at least 50% of the voting shares. Commonly the CEO was a shareholder too in these kinds of companies.

The explanation and description made in this dissertation will help to understand the way in which companies are managed in Mexico. However, new questions remain for future analyses.

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Figure 1: Age of Incorporation and age of initial public offerings of Mexican public traded companies

Using information from companies' annual financial reports and the National Records of Financial Securities Office (RNV) data base, figure 1 presents information on the year of incorporation and the year of initial public offering from 98 non-financial companies currently traded in the Mexican Stock Exchange (BMV). In the case of conglomerates, the year of incorporation is the year when the oldest subsidiary was founded. The same criterion is followed for initial public offerings. The average age of incorporation is 50.68 years. The average age of initial public offerings is 20.33 years.

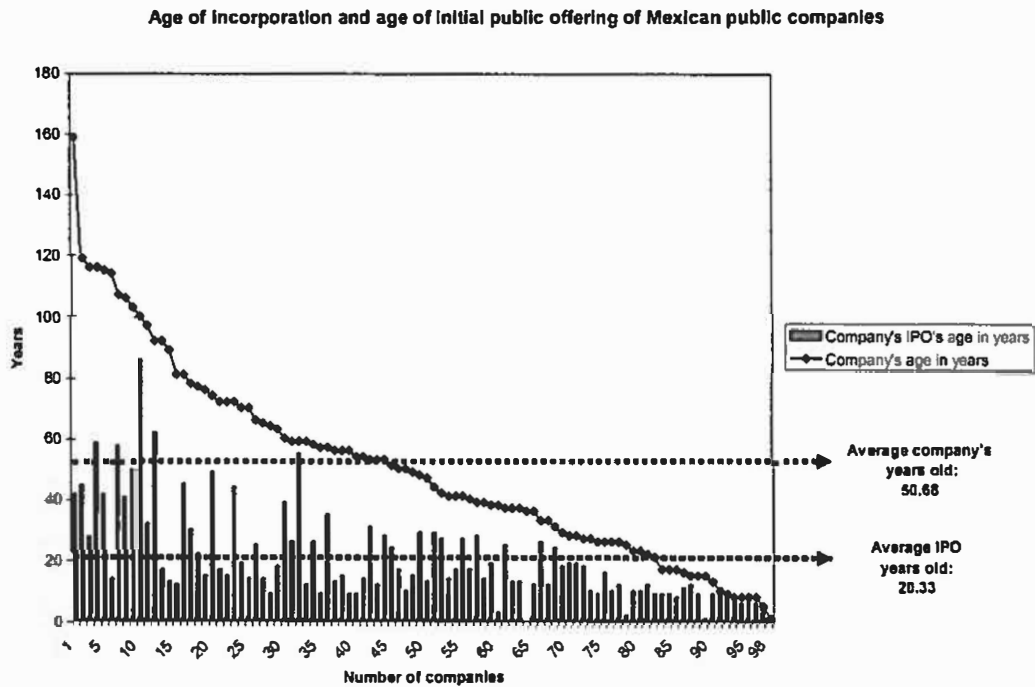


Figure 2: State of incorporation of Mexican public traded companies

Using information from companies' annual financial reports and the National Records of Financial Securities Office (RNV) data base, figure 2 presents information on the state of incorporation of 98 non-financial companies currently traded in the Mexican Stock Exchange (BMV). In the case of conglomerates, the state of incorporation is the state where the oldest subsidiary was founded.

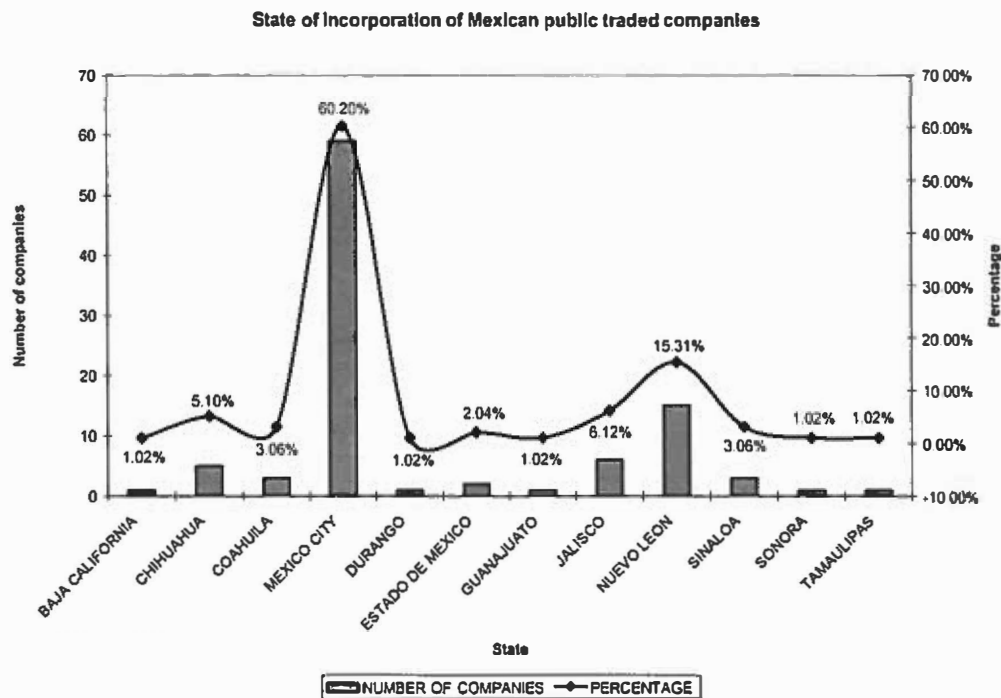


Figure 3: Number of Incorporations of Mexican public traded companies by economic history period

Using information from companies' annual financial reports and the National Records of Financial Securities Office (RNV) data base, figure 3 presents information on the economic history period of incorporation for 98 non-financial companies currently traded in the Mexican Stock Exchange (BMV). In the case of conglomerates, the period of incorporation is the year when the oldest subsidiary was founded. Six economic history periods are leveled in the X-axis. In the first period, 11 companies were incorporated this means 11.22% of the total current companies. Between 1910 and 1917, three companies were founded. During the third period, 12 companies incorporated. Between 1940 and 1970, 39 firms incorporated. During the fifth period, 17 companies incorporated, and after 1985, 16 companies were founded.

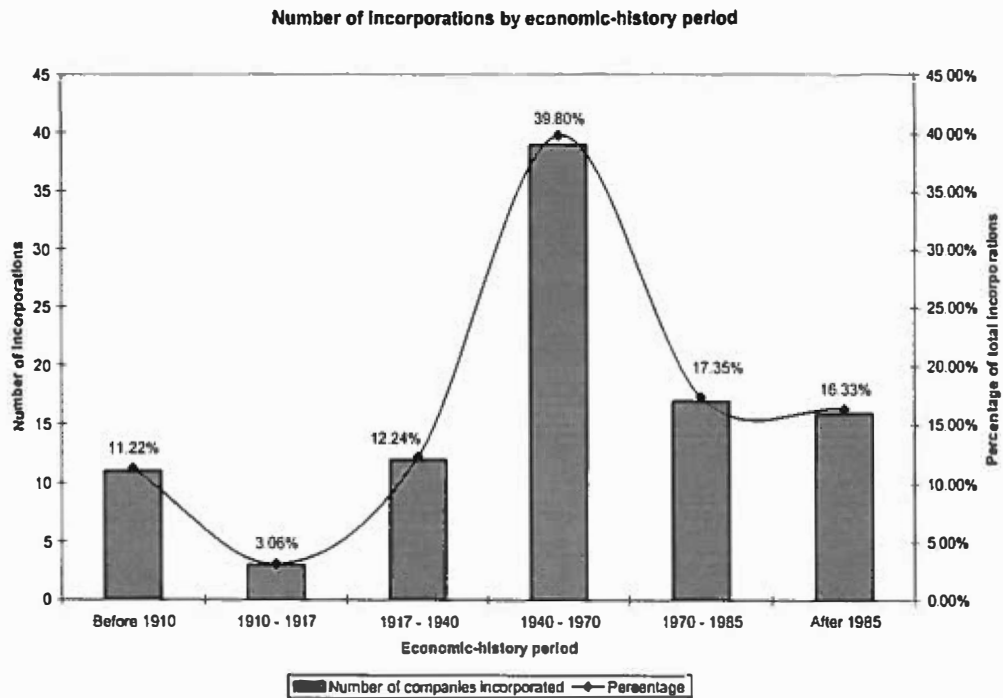


Figure 4: Number of initial public offerings (IPO) of Mexican companies by economic history period

Using information from companies' annual financial reports and the National Records of Financial Securities Office (RNV) data base, figure 4 presents information on the economic history period of initial public offerings (IPO) for 98 non-financial companies currently traded in the Mexican Stock Exchange (BMV).

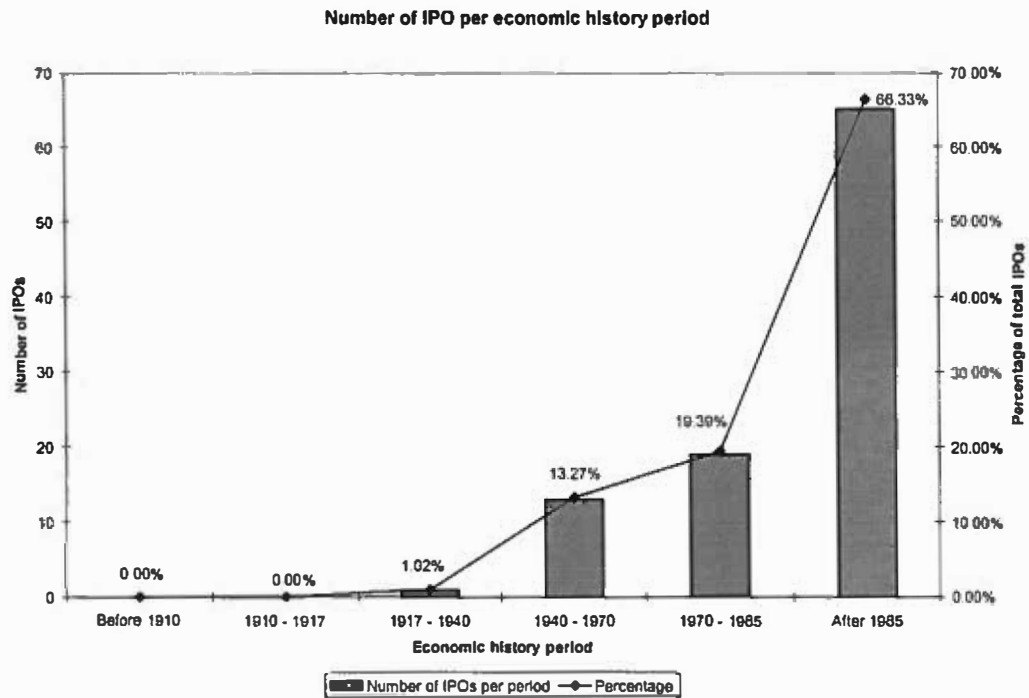


Figure 5: Non-financial Mexican public companies and their fraction of total assets

Using information from non-financial Mexican companies traded in the Mexican Stock Exchange during the years 1996, 2000 and 2005, figure 5 presents the fraction of total assets of the market that each company held during those years. The figure levels companies depending on the fraction of total assets that they hold. The companies are arbitrary divided into two groups: the 30 largest companies in terms of total assets and the small companies. All the numbers are expressed in constant Mexican pesos at December of 2005.

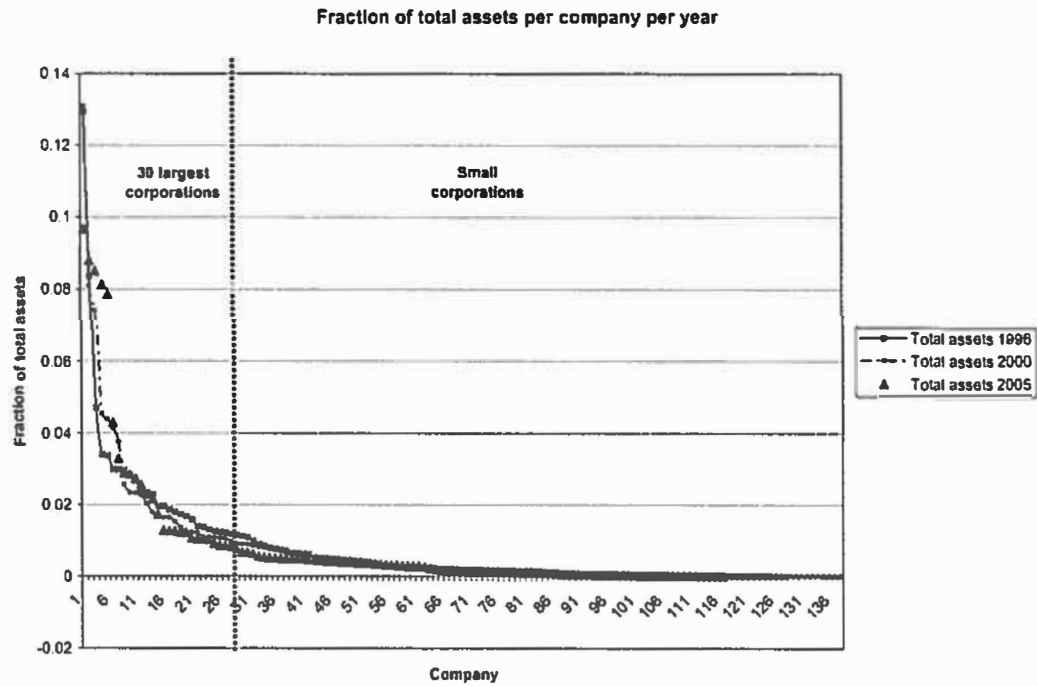


Figure 6: Evolution of the characteristics of the board of directors in the 30 largest companies and the small companies

Using information from non-financial Mexican companies that had shares traded in the Mexican Stock Exchange (BMV) during the period 1996 to 2005; figure 6 presents the evolution of the characteristics of the board of directors for the group of the 30 largest companies and the groups of small companies. Those characteristics are the size of the board measured by the average number of directors in those boards and the average number of independent directors in the boards.

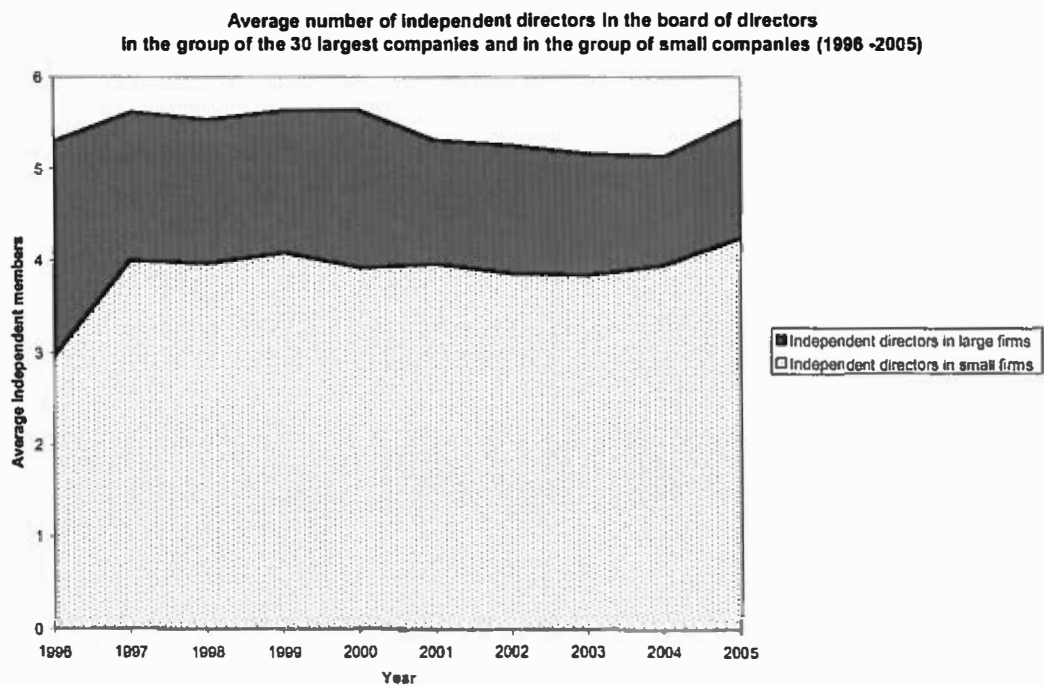
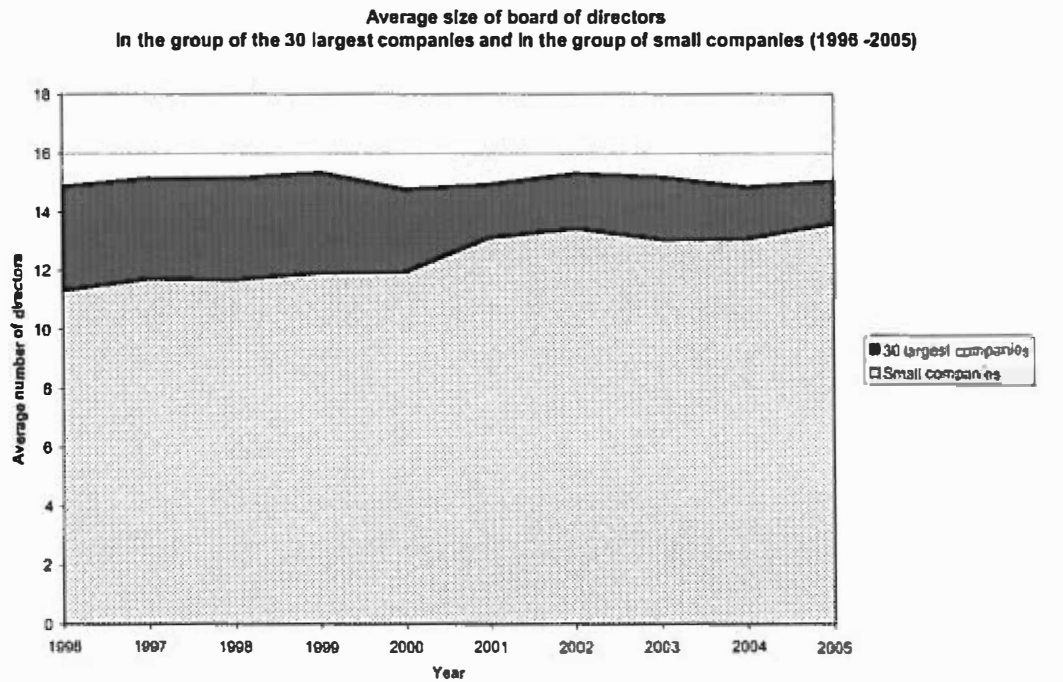
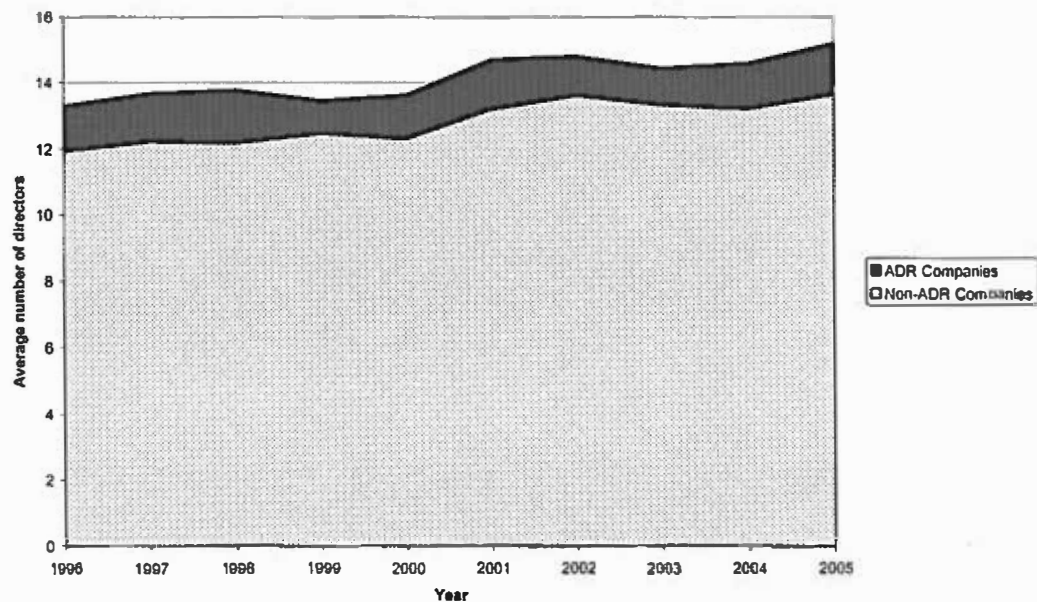


Figure 7: Evolution of the characteristics of the board of directors in the ADR's companies and the Non-ADR's companies

Using information from non-financial Mexican companies which had shares traded in the Mexican Stock Exchange (BMV) during the period 1996 to 2005, figure 7 presents the evolution of the characteristics of the board of directors for the group of the ADR companies and the groups of Non-ADR companies. Those characteristics are the size of the board measured by the average number of directors in those boards and the average number of independent directors in the boards.

**Average number of directors in the board of directors
in the ADR and Non-ADR companies (1996 -2005)**



**Average number of Independent directors in the board of directors
in the group of the ADR companies and in the group of Non-ADR companies (1996 -2005)**

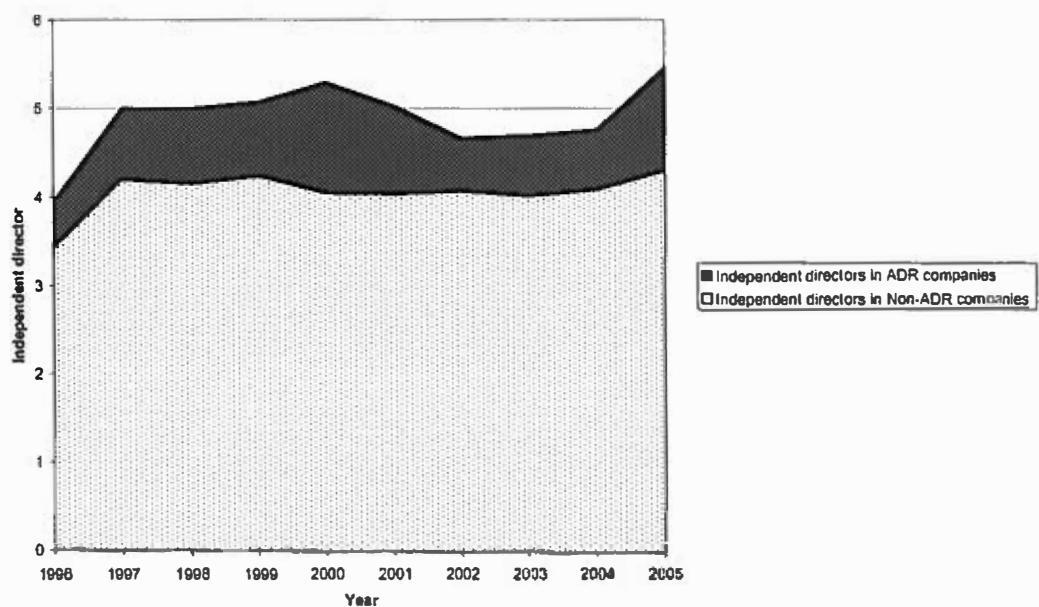


Figure 8: Evolution of financial performance per group of companies

Using information from non-financial Mexican companies traded in the Mexican Stock Exchange during the period 1996 to 2005, figure 6 presents the evolution of the financial performance measured by the Market-to-book ratio. Companies are divided into four groups: the 30 largest firms, small firms, ADR's companies and Non-ADR's companies. Those groups are not mutually exclusive.

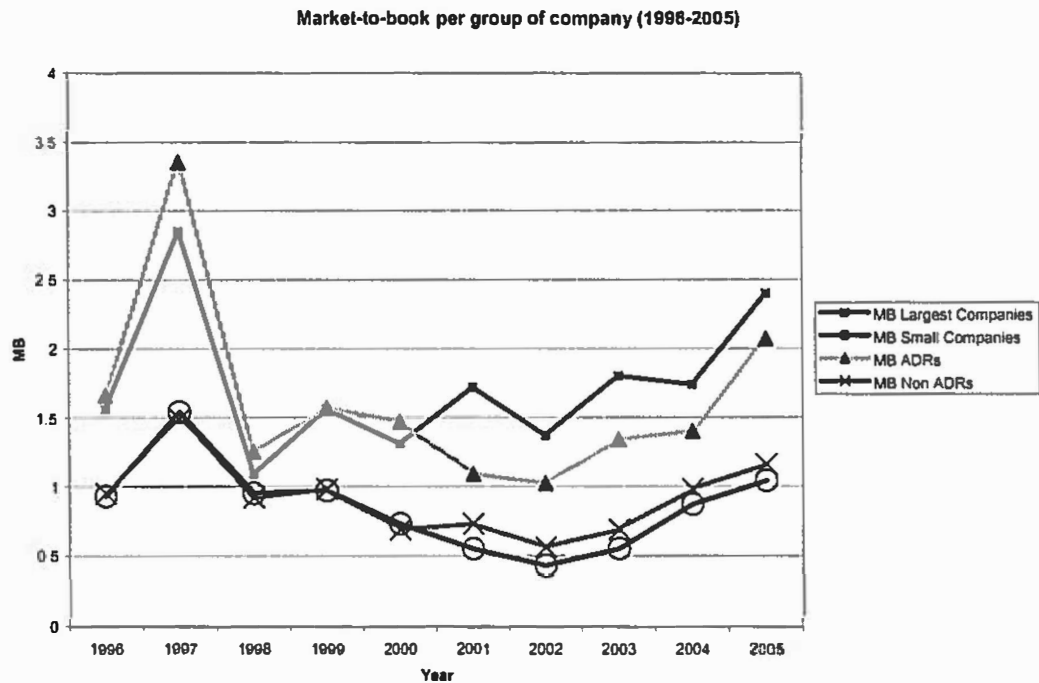


Table 1: Non-financial companies traded in 2005 in the BMV

Using information from companies' annual financial reports, the National Records of Financial Securities Office (RNV) and Lexis-Nexis data base, table 1 presents the list of non-financial companies traded in 2005 on the Mexican Stock Exchange (BMV), their years of incorporation and the years of their initial public offering. In the case of conglomerates, the year of incorporation is the year when the oldest subsidiary was formed. The same criterion is followed for initial public offerings.

Company name	Year of incorporation	Year of Initial Public Offering
1 EL PUERTO DE LIVERPOOL, S.A. DE C.V.	1847	1964
2 INDUSTRIAS PEÑALES, S.A. DE C.V.	1887	1961
3 GRUPO LAMOSA, S.A. DE C.V.	1890	1947
4 FOMENTO ECONÓMICO MEXICANO, S.A. DE C.V.	1890	1978
5 GRUPO PALACIO DE HIERRO, S.A. DE C.V.	1891	1964
6 GRUPO CASA SABA, S.A. DE C.V.	1892	1992
7 COMPAÑÍA INDUSTRIAL DE PARRAS, S.A. DE C.V.	1899	1948
8 GRUPO MÉXICO, S.A. DE C.V.	1900	1965
9 GRUPO SANBORNS, S.A. DE C.V.	1903	1956
10 CEMEX, S.A. DE C.V.	1906	1920
11 VITRO, S.A. DE C.V.	1909	1974
12 EMBOTELLADORAS ARCA, S.A. DE C.V.	1914	1944
13 GRUPO HERDEZ, S.A. DE C.V.	1914	1989
14 FARMACIAS BENAVIDES, S.A. DE C.V.	1917	1993
15 KIMBERLY-CLARK DE MÉXICO, S.A. DE C.V.	1925	1961
16 GRUPO MODELO, S.A. DE C.V.	1925	1994
17 GRUPO INDUSTRIAL SALTILLO, S.A. DE C.V.	1928	1976
18 SANLUIS CORPORACIÓN, S.A. DE C.V.	1929	1984
19 CONTROLADORA COMERCIAL MEXICANA, S.A. DE C.V.	1930	1991
20 BBVA BANCOMER, S.A. DE C.V.	1932	1957
21 INDUSTRIAS CH, S.A. DE C.V.	1934	1962
22 CINTRA, S.A. DE C.V.	1934	1989
23 ECKO, S.A. DE C.V.	1934	1991
24 GRUPO LA MODERNA, S.A. DE C.V.	1936	1987
25 GRUPO IMSA, S.A. DE C.V.	1936	1992
26 GRUPO BIMBO, S.A. DE C.V.	1940	1981
27 CEMENTOS CHIHUAHUA, S.A. DE C.V.	1941	1992
28 FRAGUA, S.A. DE C.V.	1942	1997
29 CORPORACIÓN MOCTEZUMA, S.A. DE C.V.	1943	1988
30 EDITORIAL DIANA, S.A. DE C.V.	1946	1967
31 TELÉFONOS DE MÉXICO, S.A. DE C.V.	1947	1951
32 EMPRESAS ICA, S.A. DE C.V.	1947	1980
33 JUGOS DEL VALLE, S.A. DE C.V.	1947	1994
34 EDOARDOS MARTÍN, S.A. DE C.V.	1948	1980
35 GRUMA, S.A. DE C.V.	1949	1971
36 GRUPO COLLADO, S.A. DE C.V.	1949	1997
37 GRUPO TELEVISIÓN, S.A. DE C.V.	1950	1991
38 GRUPO ELEKTRA, S.A. DE C.V.	1950	1993
39 TV AZTECA, S.A. DE C.V.	1950	1997
40 GRUPO RADIO CENTRO, S.A. DE C.V.	1952	1992
41 INDUSTRIAS BACHOCO, S.A. DE C.V.	1952	1997
42 COMPAÑÍA MINERA AUTLAN, S.A. DE C.V.	1953	1975
43 MEXICHEM, S.A. DE C.V.	1953	1978

Table 1: Non-financial companies traded in 2005 in the BMV continued

Company name	Year of incorporation	Year of Initial Public Offering
44 GRUPO DIXON, S.A. DE C.V.	1953	1994
45 CONSORCIO ARISTOS, S.A. DE C.V.	1955	1982
46 AMERICA MOVIL, S.A. DE C.V.	1956	1989
47 TEKCHEM, S.A. DE C.V.	1956	1996
48 INDUSTRIA AUTOMOTRIZ, S.A. DE C.V.	1957	1991
49 WAL-MART DE MÉXICO, S.A. DE C.V.	1958	1977
50 GRUPO MEXICANO DE DESARROLLO, S.A. DE C.V.	1959	1993
51 GRUPO GIGANTE, S.A. DE C.V.	1962	1977
52 GRUPO CONTINENTAL, S.A. DE C.V.	1964	1979
53 CYDSA, S.A. DE C.V.	1965	1979
54 CORPORACIÓN MEXICANA DE RESTAURANTES, S.A. DE C.V.	1965	1989
55 COPPEL, S.A. DE C.V.	1965	1992
56 EMPRESAS CABLEVISIÓN, S.A. DE C.V.	1966	1989
57 ALFA, S.A. DE C.V.	1967	1978
58 GRUPO POSADAS, S.A. DE C.V.	1967	1992
59 ORGANIZACIÓN SORIANA, S.A. DE C.V.	1968	1987
60 SARE HOLDINGS, S.A. DE C.V.	1968	2003
61 GRUPO MARTI, S.A. DE C.V.	1969	1981
62 PROMOTORA Y OPERADORA DE INFRAESTRUCTURA, S.A. DE C.V.	1969	1993
63 SIMEC, S.A. DE C.V.	1969	1993
64 GRUPO PROFESIONAL PLANEACIÓN Y PROYECTOS, S.A. DE C.V.	1970	1994
65 GRUPO FAMSA, S.A. DE C.V.	1970	2006
66 DESC, S.A. DE C.V.	1973	1980
67 CORPORACIÓN GEO, S.A. DE C.V.	1973	1994
68 CORPORACIÓN DURANGO, S.A. DE C.V.	1975	1982
69 CONSORCIO ARA, S.A. DE C.V.	1977	1988
70 INTERNACIONAL DE CERAMICA, S.A. DE C.V.	1978	1987
71 GRUPO DE EMBOTELLADORAS UNIDAS, S.A. DE C.V.	1978	1987
72 ACCEL, S.A. DE C.V.	1979	1988
73 CONVERTIDORA INDUSTRIAL, S.A. DE C.V.	1979	1996
74 GRUPO CARSO, S.A. DE C.V.	1980	1990
75 MEDICA SUR, S.A. DE C.V.	1980	1994
76 HILASAL, S.A. DE C.V.	1980	1996
77 GRUPE, S.A. DE C.V.	1980	1997
78 DESARROLLOS URBANOS, S.A. DE C.V.	1981	2004
79 GRUPO BAFAR, S.A. DE C.V.	1983	1996
80 DERMET, S.A. DE C.V.	1983	1996
81 GRUPO QUMMA, S.A. DE C.V.	1984	1994
82 CONSORCIO HOGAR, S.A. DE C.V.	1985	1997
83 ECE, S.A.	1989	1997
84 GRUPO CDMEERIAL GOMO, S.A. DE C.V.	1989	1997
85 DESRROLLADORA HOMEX, S.A. DE C.V.	1989	1998
86 CORPORACIÓN INTERAMERICANA DE ENTRETENIMIENTO, S.A. DE C.V.	1990	1995
87 GRUPO MAC'MA, S.A. DE C.V.	1991	1994
88 BIPER, S.A. DE C.V.	1991	1997
89 PROMOTORA AMBIENTAL, S.A. DE C.V.	1991	2005
90 GRUPO MINSAL, S.A. DE C.V.	1993	1997
91 CARSO GLOBAL TELECOM, S.A. DE C.V.	1996	1996
92 ALSEA, S.A. DE C.V.	1997	1997
93 GRUPO AEROPORTUARIO DEL SURESTE, S.A. DE C.V.	1998	1998
94 GRUPO AEROPORTUARIO DEL PACÍFICO, S.A. DE C.V.	1998	1998
95 GRUPO ISUACELL, S.A. DE C.V.	1998	2000
96 UNEFON, S.A. DE C.V.	1998	2000
97 AMERICA TELECOM, S.A. DE C.V.	2001	2001
98 IMPULSORA DEL DESARROLLO Y EL EMPLEO EN AMERICA LATINA, S.A. DE C.V.	2005	2005

Table 2: Significant economic milestones in the Mexico's economic history and the historic period when they occurred

Economic history period	Relevant economic facts
Before 1910	<ul style="list-style-type: none"> • First securities traded in 1850 • The Mexican Stock Exchange incorporated in 1886 • Regional development (north and central Mexico) • Economy based on agricultural, mining and textile industries • Communication (roads, rail, telephone and telegraph) • First commercial laws • The National Banking Commission (the prototype of the Mexican SEC) began its functions in 1904 • Foreign investment from France, England and the United States
1910 – 1917	<ul style="list-style-type: none"> • Civil War severely disrupted the Mexican economy • Disruption of communications • Agricultural and manufacturing distribution unreliable • Banking system shattered • Public credit and currency disappeared • Regional development helped industries • New Federal Constitution in 1917 (Prohibited the monopoly, but allowed the State to retain strategic industries)
1917 – 1940	<ul style="list-style-type: none"> • Central bank incorporated in 1925 • Bank Commission founded in 1925 • The Institutional Revolution Party is founded in 1929 • The Great Depression did not have significant impact on the Mexican economy • Intensive nationalization in petroleum, railroads, land and strategic industries • General Mercantile Law (LGSM) enacted in 1933 • Industrialization on import-substitution basis
1940 – 1970	<ul style="list-style-type: none"> • WWII brought capital in-flows to Mexico • Government protected domestic industries with a full-scale import substitution program • GDP growth 7% on average per year between 1954 and 1970 • Manufacturing remained as the country's dominant sector • Growth on capital goods imports • Companies used internal capital markets and commercial banks loans to finance their activities
1970 – 1985	<ul style="list-style-type: none"> • Social and political riots • Fiscal mismanagement • Deterioration of the investment climate • Disequilibrium occurred in the balance of payments • Oil and petrochemicals became the most dynamic sectors • Law of exchange securities enacted in 1975 • Commercial bank activities improved in 1976 • Treasury bills and debt market in 1978 • Devaluations because of falling in oil prices, high global interest rates in the world and rising inflation • Federal government declared an involuntary moratorium on debt payments • Dual class shares • Nationalization of the commercial banks
After 1985	<ul style="list-style-type: none"> • Mexico joins the WTO • Denationalization and deregulation of the economy • Fiscal discipline implemented • Companies went public • NAFTA. • Banking crisis in 1995 and the "Tequila Effect"

Table 3: Corporate rights recommended by the Organization for Economic Cooperation and Development (OECD) and their presence in the Mexican mercantile system

Recommendation from OCDE	Mexican practice
Shareholders of the same class are treated equally	Yes (law)
Insider trading prohibited	Yes (law)
Directors and officers are required to disclosure any material interests affecting the company	Yes (law)
Accurate, timely, and relevant information given to shareholders	Yes (law)
Accurate, timely, and relevant information given to directors	Not specified
External annual audit required	Yes (law)
Disclosure of financial and corporate governance information	Yes for public companies
Information prepared, audited, and disclosed according to accounting principles	Yes (law)
Efficient and transparent markets for corporate control	Not developed
Employee representation on board of director	Not allowed
Role of the board of directors	Hiring, firing, compensate and counseling top management
Sufficient percentage of independent directors	25%

Table 4: Characteristics of each class of shares issued by Mexican public corporations

Using information from the Mexican Stock Exchange (BMV) and the National Records of Financial Securities Office (RNV), table 4 presents information for each class of share issued by Mexican companies. Mexican / foreign ownership means if the share can be bought by foreign investors or only Mexican investors. Maximum percentage of capital means the maximum portion of the company's capital that the class of share represents. Share rights means if the share is voting, non-voting or limited class. Director represents the share classes' rights to name a director who represent them in the board of directors.

Share class	Mexican / Foreign ownership	Maximum percentage of capital	Share rights	Directors
A	Mexican only	100%	Voting	Designate the majority of the directors
B	Mexican and foreign	100%	Voting	Designate the majority of the directors
C	Mexican and foreign	25%	Non-voting	None
D	Mexican and foreign	25%	Limited	One director for each 10%; maximum of two per shareholder
L	Mexican and foreign	25%	Limited	One director for each 10%; maximum of two per shareholder
CPOs	Mexican and foreign	Variable	Depends on the bylaws	Depends on the bylaws
O	Mexican (financial groups only)		Voting	One director for each 10%; maximum of two per shareholder

Table 5: Class of shareholders' meetings in Mexican corporations and their characteristics

Table 5 contains the characteristics of the shareholders' meetings. Duty represents the decisions made by class of meeting. Class of shares means the class of shares that must be represented by meeting. Time indicates when the shareholders' meeting has to be done. Decision represents how a decision is made in the shareholders' meeting

Class	Duty	Class of shares	Time	Decision
Ordinary	<p>To know and approve the financial and operating reports presented by the company management</p> <p>To elect the members of the board of directors and the committees</p> <p>To determine the compensation for the directors</p>	Only voting shares	It must take place the four following months after the closing of the financial year of the firm	50% of the voting shares must be represented; the decision is made when the relative majority votes in one direction
Extraordinary	<p>To extend the term of the company</p> <p>To dissolve the company</p> <p>To increase or reduce the capital</p> <p>To change the purpose of the firm</p> <p>To change the nationality of the company</p> <p>To transform the company</p> <p>To merge the firm</p>	Voting shares and limited shares	It can take place when the board of directors calls for a meeting, or when a group of shareholders that represent at least 33% of voting shares calls for a meeting	75% of the involved classes of shares must be represented; the decision is made when the absolute majority votes in one direction

Table 6: Data sets and their sources of information

Data set	Source of information
Operating and financials	<ol style="list-style-type: none"> 1. Economatica 2. Mexican corporations' annual financial reports 3. Mexican Stock Exchange data base 4. World Federation of Exchanges data base
Ownership information	<ol style="list-style-type: none"> 1. Ordinary shareholders' meeting acts 2. Mexican depository securities institute (INDEVAL) 3. Mexican corporations' annual financial reports 4. Mexican Stock Exchange data base 5. Lexis-Nexis electronic data base
Board of directors	Ordinary shareholders' meeting acts

Table 7: Companies that integrated the sample

Using information from the data set, table 7 describes the number of Mexican public companies that integrate the sample per year.

Description of companies	1996	2000	2005
Companies listed in the Mexican Stock Exchange (BMV)	193	173	150
Financial companies listed in the BMV	66	36	34
Non-financial companies listed in the BMV	127	137	116

Table 8: Financial performance and corporate governance of the Mexican non-financial public companies categorized by their size

Using information from non-financial Mexican companies with shares traded in the Mexican Stock Exchange (BMV) during the years 1996, 2000 and 2005, table 8 presents the description of the financial performance and the corporate governance for the group of the 30 largest companies and the group of the small companies. The panel A contains three measures of financial performance: the average (median) of the total assets expressed in billion of Mexican pesos. Leverage is the average (median) of the book value of debt with respect to the market value of total assets. Market-to-book is the average (median) of financial performance. All the numbers are expressed in constant Mexican pesos at December of 2005. Panel B contains descriptions of the boards of directors. Number of directors is the average (median) of the number of directors that integrated the board in Mexican companies. Independent directors is the average (median) of the fraction of independent directors with respect the total number of directors that integrated the board of a company. Non-independent director is the average (median) of the fraction of non-independent directors with respect the total number of directors that integrated the board of a company. CEO is the chairman is the average of the fraction of companies in the group with the same individual serving as both chairman of the board and CEO. Panel C presents information about the boards of directors' appointments. Directors with outside appointments represents the average (median) of number of directors per board that at least had one seat in another company's board. Total outside appointments per board is the average (median) of the total number of outside appointments that all the members of a company's board of directors had. Interlock per company is the average (median) of number of cases on when a director of one company had one seat in another company's board and one director from the last company had a seat in the first company too.

	30 largest companies			Small companies		
	1996	2000	2005	1996	2000	2005
Panel A: Operating data						
Total assets (P\$Bill)	48.31 (53.00)	64.89 (40.24)	81.61 (38.07)	4.10 (2.80)	4.80 (2.47)	5.70 (3.55)
Leverage (%)	47.27 (46.29)	54.10 (56.85)	52.24 (48.66)	44.81 (43.51)	59.66 (50.31)	70.69 (47.75)
Market-to-book (%)	156.32 (140.00)	131.34 (95.00)	240.00 (170.00)	93.20 (0.00)	73.77 (45.00)	104.15 (80.00)
Panel B: Board of directors						
Number of directors per board	14.88 (14.00)	14.82 (15.00)	15.00 (14.00)	11.34 (11.00)	11.94 (12.00)	13.54 (13.00)
Independent directors per board (%)	34.21 (35.71)	37.54 (35.71)	36.75 (35.29)	27.01 (30.77)	32.22 (33.33)	32.86 (33.33)
Non-independent directors per board (%)	65.79 (64.29)	62.46 (64.29)	63.25 (64.71)	72.99 (69.23)	67.78 (66.67)	67.14 (66.67)
CEO is the chairman (%)	29.77	26.67	25.33	45.77	44.45	43.33
Panel C: Board appointments						
Directors with outside appointments	2.88 (3.00)	3.52 (3.00)	2.67 (3.00)	1.74 (2.00)	2.01 (2.00)	1.28 (1.00)
Total outside appointments per board	16.63 (19.00)	26.26 (28.00)	18.12 (19.00)	5.85 (4.00)	9.02 (2.00)	5.15 (1.00)
Interlock per company's board	1.76 (2.00)	2.23 (2.00)	2.22 (2.00)	0.41 (0.00)	0.43 (0.00)	0.47 (0.00)

Table 9: Ownership of the Mexican companies categorized by size

Using information from non-financial Mexican companies with shares traded in the Mexican Stock Exchange (BMV) during the years 1996, 2000 and 2005, table 9 presents the description of the ownership for the group of the 30 largest companies and the group of the small companies. Panel A categorizes the companies upon the type of their largest shareholder. Family companies represent the number of companies which their largest shareholder was a family. Mexican company represents the number of firms which their largest shareholder was a Mexican company; these firms were subsidiaries of a Mexican private firm. Foreign company represents the number of firms which their largest shareholder was a foreign company; these companies are foreign subsidiaries. Unidentified-owner company represents the number of firms that their largest shareholder was not identified. Panel B presents information about the average percentage of voting shares held by the largest shareholder per subgroup. Panel C shows the ownership held by the board and the CEO. Board of directors has more than 50% represents the average fraction of firms from the total companies in the group that the members of their board of directors held at least the 50% of the voting shares of the company. CEO is shareholder represents the fraction of firms of the total companies in the group that their CEO was also a shareholder.

	30 largest companies			Small companies		
	1996	2000	2005	1996	2000	2005
Panel A: Companies' largest shareholder						
Family company	18	20	20	47	46	47
Mexican company	4	6	7	15	17	14
Foreign company	3	2	2	9	11	7
Unidentified-owner company	4	1	2	23	26	17
Panel B: Fraction of voting shares held by largest shareholder						
Family company (%)	42.77	38.50	33.69	31.53	30.82	42.44
Mexican company (%)	27.58	29.71	33.12	36.51	38.25	49.13
Foreign company (%)	17.36	26.05	44.00	30.32	25.45	33.65
Unidentified-owner company (%)	3.56	15.46	4.46	11.62	10.30	27.16
Panel C: Ownership of board and CEO						
Board of directors has more 50% (%)	43.00	42.45	63.63	63.33	66.67	67.74
CEO is shareholder (%)	32.00	31.13	50.00	56.57	53.33	54.84

Table 10: Characteristics of ownership of family firms

Using information from non-financial Mexican companies with shares traded in the Mexican Stock Exchange (BMV) during the years 1996, 2000 and 2005, table 10 presents the description of the characteristics of the ownership of the family firms for the group of the 30 largest companies and the group of the small companies. Shares own by the family is the average (median) percentage of voting shares of a company held by a family. Shares owned by the largest family shareholder represents the average (median) fraction of voting shares on the hands of the member of the family who held more shares. Number of members in the family represents the average (median) number of members who held voting shares of the company.

	30 largest companies			Small companies		
	1996	2000	2005	1996	2000	2005
Shares owned by the family (%)	42.72 (36.78)	38.50 (36.82)	33.69 (35.56)	31.53 (29.58)	30.82 (30.19)	42.44 (43.99)
Shares owned by the largest family shareholder (%)	17.56 (35.63)	14.25 (36.30)	10.84 (33.70)	9.94 (29.58)	9.50 (30.19)	17.73 (40.70)
Number of members in the family	2.61 (1.00)	2.65 (1.00)	2.60 (1.00)	2.12 (1.00)	2.00 (1.00)	2.00 (1.00)

Table 11: ADR's companies and Non-ADR's companies from the 30 largest companies group and the small companies group

Using information from non-financial Mexican companies which had shares traded in the Mexican Stock Exchange (BMV) during the years 1996, 2000 and 2005; table 11 presents the fraction (number) of firms that had American Depository Receipts (ADR) per group of companies.

	ADR companies	Non - ADR companies
30 Large companies	60.17	43.24
1996	(9)	(21)
Small companies	9.46	3.24
1996	(14)	(86)
30 Large companies	56.46	74.53
2000	(16)	(14)
Small companies	9.47	4.15
2000	(13)	(93)
30 Large companies	93.59	70.40
2005	(15)	(15)
Small companies	11.43	4.53
2005	(15)	(73)

Table 12: Financial performance and corporate governance of the Mexican non-financial public companies categorized by ADR's and Non-ADR's companies

Using information from non-financial Mexican companies which had shares traded in the Mexican Stock Exchange (BMV) during the years 1996, 2000 and 2005; table 12 presents the description of the financial performance and the corporate governance for the group of the ADR's companies and the group of the Non-ADR's companies. The panel A contains three measures of financial performance: the average (median) of the total assets expressed in billion of Mexican pesos. Leverage is the average (median) of the fraction of the book value of debt with respect to the market value of total assets. Market-to-book is the average (median) of financial performance. All the numbers are expressed in constant Mexican pesos at December of 2005. Panel B contains descriptions of the boards of directors. Number of directors is the average (median) of the number of directors who integrated the board in Mexican companies. Independent directors is the average (median) of the fraction of independent directors with respect to the total number of directors who integrated the board of a company. Non-independent director is the average and (median) of the fraction of non-independent directors with respect to the total number of directors who integrate the boards of companies. CEO is the chairman is the average of the fraction of companies in the group with the same individual serving as both chairman of the board and CEO. Panel C presents information about the boards of directors' appointments. Directors with outside appointments represents the average (median) of number of directors per board that at least had one seat in another company's board. Total outside appointments per board is the average (median) of the total number of outside appointments that all the members of a company's board of directors had. Interlock per company is the average (median) of number of cases on when a director of one company had one seat in another company's board and one director from the last company had a seat in the first company too.

	ADR companies			Non-ADR companies		
	1996	2000	2005	1996	2000	2005
Panel A: Operating data						
Total assets (P\$Bill)	29.30 (14.70)	35.39 (25.61)	52.50 (23.09)	11.08 (3.21)	13.36 (3.22)	16.37 (3.74)
Leverage (%)	38.70 (35.75)	51.64 (56.50)	56.00 (57.02)	46.82 (45.05)	60.27 (49.94)	69.22 (47.43)
Market-to-book (%)	166.50 (130.00)	147.60 (100.00)	207.20 (150.00)	95.14 (10.00)	69.91 (40.00)	116.74 (90.00)
Panel B: Board of directors						
Number of directors per board	12.95 (13.00)	13.85 (13.00)	14.89 (14.00)	12.01 (12.00)	12.26 (12.00)	13.61 (13.00)
Independent directors per board (%)	29.24 (33.33)	37.35 (38.10)	36.88 (35.29)	28.63 (33.33)	32.33 (33.33)	32.91 (33.33)
Non-independent directors per board(%)	70.76 (66.67)	62.65 (61.90)	63.12 (64.71)	71.37 (66.67)	67.67 (66.67)	67.09 (66.67)
CEO is the chairman (%)	25.25	25.01	25.00	47.44	47.00	46.34
Panel C: Board appointments						
Directors with outside appointments	3.78 (4.00)	5.03 (5.00)	4.16 (4.00)	2.30 (1.00)	3.50 (2.00)	2.87 (1.00)
Total outside appointments per board	12.17 (9.00)	17.00 (14.00)	11.80 (9.50)	7.51 (2.00)	11.70 (3.00)	7.43 (2.00)
Interlock per company's board	1.26 (1.00)	1.58 (1.00)	1.53 (1.00)	0.60 (0.00)	0.62 (0.00)	0.73 (0.00)

Table 13: Ownership of the Mexican corporations categorized by ADR's companies and Non-ADR's companies

Using information from non-financial Mexican companies which had shares traded in the Mexican Stock Exchange during the years 1996, 2000 and 2005; table 13 presents the description of the ownership for the group ADR's companies and the group of Non-ADR's companies. Panel A categorizes the companies upon the type of their largest shareholder. Family companies represent the number of companies which their largest shareholder was a family. Mexican company is the number of firms which their largest shareholder was a Mexican company; these firms were subsidiaries of a Mexican firm. Foreign company represents the number of firms which their largest shareholder was a foreign company. Unidentified-owner company represents the number of firms that their largest shareholder was not identified and the largest fraction of their shares were in the market. Panel B presents information about the average percentage of voting shares held by the largest shareholder on each subgroup of companies. In the case of the unidentified-owner company this percentage is the amount of shares in the hands of the market. Panel C shows the ownership held by the board and the CEO. Board of directors has more than 50% represents the average fraction of firms of the group of companies that the members of their board of directors held at least the 50% of the voting shares of the company. CEO is shareholder represents the fraction of firms of the group of companies that their CEO was a shareholder.

	ADR companies			Non-ADR companies		
	1996	2000	2005	1996	2000	2005
Panel A: Companies' largest shareholder						
Family company	15	16	16	50	50	51
Mexican company	5	5	6	14	18	15
Foreign company	2	3	2	10	10	7
Unidentified-owner company	2	3	4	25	24	15
Panel B: Fraction of voting shares held by largest shareholder						
Family company (%)	35.30	31.93	37.03	34.48	33.53	40.71
Mexican company (%)	49.77	48.53	53.70	29.22	32.54	39.83
Foreign company (%)	45.75	30.50	44.00	23.35	24.05	33.65
Unidentified-owner company (%)	7.13	5.15	25.90	10.69	11.16	24.46
Panel C: Ownership of board and CEO						
Board of directors has more 50% (%)	44.86	43.93	64.04	60.87	62.07	66.67
CEO is shareholder (%)	35.51	33.64	52.81	47.83	44.83	46.67

Table 14: Characteristics of ownership of Mexican family firms categorized by ADR's companies and Non-ADR's companies

Using information from non-financial Mexican companies which had shares traded in the Mexican Stock Exchange (BMV) during the years 1996, 2000, and 2005; table 14 presents the description of the characteristics of the ownership of the family firms of the group of ADR's companies and the group of Non-ADR's companies. Shares own by the family is the average (median) percentage of voting shares of a company held by the family. Shares owned by the largest family shareholder represents the average (median) fraction of voting shares on the hands of the member of the family who held more shares. Number of members in the family represents the average (median) number of members who held voting shares of the company.

	ADR companies			Non-ADR companies		
	1996	2000	2005	1996	2000	2005
Shares owned by the family (%)	35.30 (29.58)	31.93 (27.58)	37.03 (38.53)	34.48 (34.88)	33.53 (35.31)	40.71 (37.30)
Shares owned by the largest family shareholder (%)	12.46 (32.33)	10.20 (26.45)	13.71 (26.33)	32.22 (33.22)	31.22 (33.38)	33.12 (36.10)
Number of members in the family	3.00 (2.00)	2.87 (1.00)	2.87 (1.00)	2.07 (1.00)	1.98 (1.00)	1.96 (1.00)

Table 15: Financial performance and corporate governance of the Mexican non-financial public ADR's companies categorized by large companies and small companies

Using information from non-financial Mexican companies which had shares traded in the Mexican Stock Exchange (BMV) during the years 1996, 2000, and 2005; table 15 presents the description of the financial performance and the corporate governance for the group of the large ADR companies and the group of small ADR companies. The panel A contains three measures of operating performance: the average (median) of the total assets expressed in billion of Mexican pesos. Leverage is the average (median) of the fraction of the book value of debt with respect to the market value of total assets. Market-to-book is the average (median) of financial performance. All the numbers are expressed in constant Mexican pesos at December of 2005. Panel B contains descriptions of the boards of directors. Number of directors is the average (median) of the number of directors who integrated the board in Mexican companies. Independent directors is the average (median) of the fraction of independent directors with respect the total number of directors who integrated the board of a company. Non-independent director is the average and (median) of the fraction of non-independent directors with respect the total number of directors that integrate the board of a company. CEO is the chairman is the average of the fraction of companies in the group with the same individual serving as both chairman of the board and CEO. Panel C presents information about the boards of directors' appointments. Directors with outside appointments represents the average (median) of number of directors per board that at least had one seat in another company's board. Total outside appointments per board is the average (median) of the total number of outside appointments that all the members of a company's board of directors had. Interlock per company is the average (median) of number of cases on when a director of one company had one seat in another company's board and one director from the last company had a seat in the first company too.

	Large ADR companies			Small ADR companies		
	1996	2000	2005	1996	2000	2005
Panel A: Operating data						
Total assets (P\$BIII)	60.17 (34.12)	56.46 (38.11)	93.59 (51.38)	9.46 (10.27)	9.47 (8.55)	11.42 (11.45)
Leverage (%)	57.41 (43.30)	57.02 (57.61)	56.59 (55.46)	26.67 (24.80)	45.02 (54.30)	55.06 (58.84)
Market-to-book (%)	193.29 (159.59)	151.90 (100.00)	303.33 (230.00)	149.29 (110.00)	142.31 (90.00)	111.06 (110.00)
Panel B: Board of directors						
Number of directors	14.33 (14.00)	14.64 (14.00)	15.46 (14.00)	11.91 (12.00)	13.00 (12.00)	14.28 (14.00)
Independent directors per board (%)	37.51 (38.46)	40.05 (38.46)	39.86 (35.71)	23.03 (25.17)	34.44 (36.36)	33.69 (34.31)
Non-independent directors per board (%)	62.49 (61.54)	59.95 (61.54)	60.14 (64.29)	76.97 (74.83)	65.56 (63.64)	66.31 (65.69)
CEO is the chairman (%)	25.05	27.88	25.84	27.45	28.67	29.55
Panel C: Board appointments						
Directors with outside appointments	3.33 (3.00)	3.50 (3.00)	2.78 (2.00)	2.16 (2.00)	2.25 (2.00)	1.61 (1.50)
Total outside appointments per board	18.88 (24.00)	22.68 (26.00)	16.00 (19.00)	7.85 (8.00)	10.00 (9.00)	7.60 (7.00)
Interlock per company's board	1.88 (2.00)	2.18 (2.50)	2.40 (2.00)	0.85 (0.00)	0.84 (0.00)	.66 (0.00)

Table 16: Ownership of the Mexican ADR's corporations categorized by large companies and small companies

Using information from non-financial Mexican companies which had shares traded in the Mexican Stock Exchange (BMV) during the years 1996, 2000, and 2005; table 16 presents the description of the ownership for the groups of large ADR's companies and small ADR's companies. Panel A categorizes the companies in subgroups upon the type of their largest shareholder. Family companies represent the number of companies which their largest shareholder was a family. Mexican company is the number of firms which their largest shareholder was Mexican company; these firms were subsidiaries of a Mexican firm. Foreign company represents the number of firms which their largest shareholder was a foreign company. Unidentified-owner company represents the number of firms that their largest shareholder was not identified. Panel B presents information about the average percentage of voting shares holding by the largest shareholder. In the case of unidentified-owner company, the percentage represents the shares in the hands of the market. Panel C shows the ownership held by the board and the CEO. Board of directors has more than 50% represents the average fraction of firms of the total companies that the members of their board of directors held at least the 50% of the voting shares of the company. CEO is shareholder represents the fraction of firms of the total companies that their CEO was shareholder.

	Large ADR companies			Small ADR companies		
	1996	2000	2005	1996	2000	2005
Panel A: Companies' largest shareholder						
Family company	6	11	9	7	5	7
Mexican company	1	1	3	4	4	3
Foreign company	1	2	2	1	1	0
Unidentified-owner company	2	3	1	0	0	3
Panel B: Fraction of voting shares held by largest shareholder						
Family company (%)	38.53	28.43	26.89	32.53	39.63	50.08
Mexican company (%)	20.34	23.54	47.29	57.13	54.78	60.12
Foreign company (%)	52.10	26.05	44.00	39.40	39.40	0.00
Unidentified-owner company (%)	7.13	5.15	8.29	0.00	0.00	31.56
Panel C: Ownership of board and CEO						
Board of directors has more 50% (%)	77.78	68.75	66.67	50.00	53.85	66.67
CEO is shareholder (%)	66.67	50.00	46.67	35.71	38.46	46.67

Table 17: Characteristics of the ownership of family ADR's firms categorized by large companies and small companies

Using information from non-financial Mexican companies which had shares traded in the Mexican Stock Exchange (BMV) during the years 1996, 2000, and 2005; table 17 presents the description of the characteristics of the ownership of the family firms for the group of large ADR companies and the group of small ADR companies. Shares own by the family is the average (median) percentage of voting shares of a company held by a family. Shares owned by the largest family shareholder represents the average (median) fraction of voting shares on the hands of the member of the family who held more shares. Number of members in the family represents the average (median) number of members who held voting shares of the company.

	Large ADR companies			Small ADR companies		
	1996	2000	2005	1996	2000	2005
Shares owned by the family (%)	38.53 (37.82)	28.44 (26.78)	26.89 (35.90)	32.53 (29.58)	39.63 (34.43)	50.81 (50.90)
Shares owned by the largest family shareholder	14.85 (15.55)	8.09 (12.04)	7.23 (10.90)	10.58 (15.58)	15.71 (18.43)	25.82 (26.90)
Number of members in the family	3.33 (2.00)	3.18 (3.00)	2.88 (1.00)	2.71 (1.00)	2.20 (1.00)	2.85 (2.00)

BIOGRAPHY

Luis Eugenio De Garate Perez was born in Monterrey, Mexico, where he attended college at the Instituto Tecnológico y de Estudios Superiores de Monterrey and got a Bachelor's degree in Accounting. He attended graduate school at the Escuela de Graduados en Alta Administración y Dirección de Empresas (EGADE) of the Instituto Tecnológico y de Estudios Superiores de Monterrey, where he got a Master degree in Finance. In 2003 Luis Eugenio De Garate Perez earned the degree of Master in Management in the A. B. Freeman School of Business of the Tulane University and after this, he initiated his work to earn a Ph. D. in Finance at the A. B. Freeman School of Business of the Tulane University.

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