DOES REGULATION MATTER? AN ANALYSIS OF CORPORATE CHARTERS IN A LAISSEZ-FAIRE ENVIRONMENT*

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ABSTRACT

Are laws that protect minority investors a necessary condition for the development of stock markets? This paper attempts to answer this question using data on the origins of the corporate sector in Chile to construct an empirical analysis of the contractual provisions included in charters of corporations in the 19th century. Our findings indicate that, even though corporate law at the time was silent with respect to governance rules and investor protection, a significant number of corporations were created and their shares traded. The empirical analysis of the corporate charters reveals that these contracts frequently included provisions favourable to outside investors and the use of these provisions is consistent with the predictions of a simple agency model.

Keyword: Chile, corporate governance, corporate law

JEL Classification: N26, K22, G34

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RESUMEN

¿Son las leyes que protegen a los accionistas minoritarios una condición necesaria para el desarrollo de los mercados de capitales? Este ensayo intenta responder esta pregunta usando datos sobre los orígenes de las sociedades anónimas en Chile para desarrollar un análisis empírico de las condiciones contractuales incluidas en los estatutos de estas empresas durante el siglo XIX. Se muestra que, pese a que la legislación chilena no incluía normas referidas a gobierno corporativo y protección a accionistas minoritarios, durante este periodo se desarrolló un mercado activo. El análisis empírico revela que los estatutos de las sociedades anónimas frecuentemente incluían cláusulas que establecían derechos para los inversionistas minoritarios y que el uso de estas cláusulas contractuales es consistente con las predicciones de un modelo de agencia simple.

Palabras clave: Chile, gobierno corporativo, derecho de sociedades

1. INTRODUCTION

There is an extensive literature in economics that shows that financial markets matter for economic development. Therefore, a key question is: what factors allow financial markets to emerge and develop? In particular, are formal legal rules and regulations necessary conditions for the development of stock markets or, in their absence, can other mechanisms such as private contracts or reputation support the growth of equity markets?

This paper focuses on the problem of minority investor protection. When investing in a corporation, a small shareholder faces the risk of being subject to expropriation by the party in control of the firm. Without any explicit rights or mechanisms of control, investors will be reluctant to provide funds to corporations, hindering the development of stock markets and limiting the growth possibilities of the economy. Is legal-based investor protection the only way to solve this problem or can private contracts providing such protection be used to mitigate the agency problems faced by corporations and therefore allow the development of a capital market?

However, providing additional protection to investors might reduce the ability of a firm to pursue new projects and therefore be costly. What factors determine investor protection when it is offered at a firm level? This paper addresses these questions using evidence from corporations in 19th century Chile.

In two influential papers, La Porta *et al*. (1997, 1998) (LLSV) study how different legal systems impact financial market development. Using current data from a cross-section of forty-eight nations, they conclude that countries

with legal systems of French origin (civil law) have lower levels of investor and creditor protection than countries with English legal systems (common law) and that this lower level of protection has a negative impact on financial market development. Their research has had an undeniable impact in both academic and policy discussions[1].

Other studies, however, have challenged the LLSV argument showing that the robustness of their conclusions depends on the time frame considered. Rajan and Zingales (2003) analyse the level of development of financial markets in 1913 and conclude that in many continental European countries (civil law) the level of financial development was higher than in the United States (common law). While their results were questioned subsequently, the evidence available tends to suggest that there is no favourable difference to common law countries at the beginning of the 20th century[2].

In a related line of research, Pistor *et al.* (2002, 2003) pointed out that the main factor explaining financial underdevelopment is not legal origin *per se*, but how a country develops its legal system. They classify countries in two groups: those that developed their formal legal order internally (origins) and those that received their formal legal order from abroad (transplants) and argue that the way in which a country received its legal regime is a more important determinant of the current efficiency of its legal institutions than the legal family the country belongs to. In the specific case of corporate law, they find that transplant countries are less efficient at adapting their rules to changes in the business environment over time. Their conclusion is that the «transplant effect» is the critical element that explains the underdevelopment of the law and the financial system.

By focusing on the contents of the law, both La Porta *et al*. and Pistor *et al*. implicitly assume that firms always choose the lowest level of investor protection. However, if the law also gives corporations flexibility in terms of organisation, the approach of focusing on the letter of the law can produce a distorted picture of the «real level» of investor protection in the economy. If the law gives firms a great deal of freedom in terms of their organisation, how did the organisers of corporations choose governance rules? More specifically, what level of investor protection did they choose?

This paper analyzes the provisions included in the charters of corporations formed in Chile during the second half of the 19th century. During that period, Chilean corporate law was silent in regards to the rights of minority investors. Any rights given to corporate investors at the time should have been recorded in each firm's corporate charter (a contract that specifies the

[1] The research of La Porta *et al*. is recognised as the starting point of the «law and finance» literature. For a recent survey of the topic, see La Porta *et al.* (2008).

[2] See La Porta *et al.* (2008) who argue that the results obtained by Rajan and Zingales are distorted by the presence of outliers and have methodological errors. Sylla (2006) shows that their approach underestimates the size of the U.S. market in 1913. On the other hand, Musacchio (2010) presents data more supportive of the argument of Rajan and Zingales.

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internal governance mechanisms of a firm and the rights and duties of the different stakeholders). In order to investigate whether such protection was granted, I collect Chilean corporate charters from 1854 to 1902.

Chile is an interesting case for analysis because it was a country that laboured under a civil law regime based on the French legal system (i.e. a «transplant country» in the classification of Pistor *et al.*) and because its incorporation statutes (drafted in 1854 and not subject to significant changes throughout the 19th century) were silent regarding investor protection and corporate governance. I investigate the following research questions: did the contractual protection included in charters provide a substitute for regulation? Is it possible to identify the determinants of the degree of investor protection at a firm level?

I find that even though corporate law at that time was silent with respect to governance rules and investor protection, a significant number of corporations were created and they were able to raise significant resources from outside investors. Corporate charters frequently included provisions favourable to minority investors and the use of these provisions is consistent with the predictions of a simple agency model. That is, more protection was given to minority investors when the potential for agency problems was greater and, therefore, protection was more valuable to investors. These results show that an analysis that focuses solely on the letter on the law cannot provide a complete answer regarding the causes of stock market development.

This paper also makes a contribution to Chilean economic historiography. Chile obtained its independence from Spain in 1818. After a decade of institutional anarchy, Chile was able to consolidate its institutions and insert itself into the world economy with a development strategy characterised by an emphasis on trade and exports of basic materials. The second half of the 19th century was a period of relatively fast growth, driven first by agriculture (wheat) and then mining (silver, copper and, later in the century, nitrates). It was also the period when the first manufacturing firms were established (mainly in consumer goods and mining-related products). The literature has covered these industries and the role of corporations both as receptors of investment and engines of economic growth in detail[3]. This paper adds to the existing literature by being the first systematic analysis of the universe of corporations chartered in Chile during this period and the first to analyse their contractual provisions in detail.

[3] Several studies discuss the role of corporations in different sectors of economic activity. Veliz (1960) analyzes the creation and evolution of stock prices of maritime companies. Kirsh (1977) shows data on the ownership composition of manufacturing companies. Bravo (2000) presents detailed information about mining companies during the Caracoles boom, including shareholder lists and evidence regarding stock transactions. Oppenheimer (1982) describes how railroad companies raised capital. Pregger-Roman (1978) studies the interlocks on the boards of directors of mining and financial firms. Cavieres (1984) studies the partnerships and corporations created in Valparaíso from 1820 to 1880 and Jofre (1964) presents data regarding incorporations in Santiago. Ortega (2005) shows data on incorporations and stock subscribers from 1850 to 1880.

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The paper is also related to a growing body of research concerning law and finance during the 19th and early 20th century. Musacchio (2008) studies the evolution of creditor and shareholder rights in Brazil during 1890-1940. His main finding is that, at the end of the 19th century, Brazil had higher levels of market capitalisation over GDP and a higher level of shareholder and investor protection than today, which seems to support the Rajan and Zingales viewpoint. Miwa and Ramseyer (2000), studying the case of the Japanese cotton industry, find charter provisions that aligned the incentives of managers and shareholders and reduced the voting power of large shareholders. They argue that such provisions allowed these companies to attract a significant number of outside investors. Campbell and Turner (2011) analyse the contractual provisions of a sample of 716 British companies, finding frequent use of voting scales and maximum vote provisions. This paper contributes to this literature not only by providing additional evidence from Chile but by studying the determinants of governance mechanisms at a firm level.

The paper is organised as follows: section 2 presents a simple theoretical model of corporate charters that will be used to frame the later discussion. Section 3 discusses the main features of corporate law in Chile during the 19th century, describes the required steps in order to charter a corporation in that period and presents descriptive statistics for Chilean corporations as well as a brief description of the evolution of the stock market. Section 4 analyzes the contractual provisions included in the charters and studies the determinants of the level of investor protection observed in different companies. The conclusion follows.

2. CORPORATE CHARTERS AND INVESTOR PROTECTION: A THEORETICAL DISCUSSION

The law and finance literature argues for the existence of a positive relation between the investor protection provided by law and the level of financial market development. However, in Code Law the level of investor protection is a variable that can be contractually arranged by the organisers of the firm and outside investors; therefore private contracts can be used as substitutes for protection provided by the law. So, why do not all firms adopt a high investor rights regime? Would the lack of legally mandated protection mean that no firm would offer additional rights to their investors?

This question has been the focus of recent theoretical research (see Lamoreaux and Rosenthal 2005; Bergman and Nocolaiesvky 2006). The starting assumption is that there is some type of agency problem (manager-shareholders, controlling shareholder-minority investors and so on) that cannot be optimally solved due to some form of contractual incompleteness. One of the most studied agency problems is the case when the party in control (manager or majority investor) can extract some private benefit from controlling the firm. The usual

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assumption is that extraction is inefficient because it reduces the total value of the firm (i.e. 1 dollar diverted from the firm by the agent in control generates less than a dollar for the agent).

Assume an environment where there are no regulations regarding investor protection and where agents can freely contract on this variable, as was the case in Chile during the 19th century. In this context, increasing investor rights can have a positive effect on firm value by reducing the level of extraction of private rents by insiders and therefore attracting outside investors. However, it can also impose efficiency costs on the firm if offering a higher level of protection to outside investors leads to slower decision making[4].

A high level of investor rights, that is, more power for the shareholders' assembly, increases the cost of investor expropriation for the insiders, but at the same time it implies that potentially profitable investment projects are not realised. These «lost opportunities» can be modelled as a «delay-time» cost: If the approval of the assembly is required to make an important investment decision, the minority investors can block expropriatory projects, but, since setting up an assembly meeting takes time, by the time a decision is made the investment opportunity can be lost. Delay-time cost is more likely to be an important issue in an environment where personal transportation or communications are costly, and where corporate charters typically require formalities like newspaper publications, minimum waiting times and minimum attendance quorums in order to call a shareholder meeting. Both elements were present in Chile during the period under study.

In this set-up, it can easily be shown that a charter with higher investor rights will be preferred when the cost of the foregone opportunities is lower than the cost of tunnelling.

The analysis can be extended by adding shareholder monitoring to the basic model and exploring the substitutability between the assembly veto powers and direct shareholder monitoring. Assume that when monitoring the outside investor can identify when the entrepreneur takes an expropriatory action and can take him to court. If the cost of monitoring is low enough, and there are no significant collective action problems, both insiders and outside investors might be better off by adopting a regime with lower investors' rights.

Therefore, in equilibrium, in absence of detailed regulations regarding investor rights, if organisers are free to define governance rules and, in particular, the rights assigned to minority investors, heterogeneity in corporate arrangements should be observed. As I show in the following section, Chilean corporate law during the 19th century gave corporations a large degree of flexibility in internal governance matters. According to the theory,

[4] The objective of the model is to analyse the optimal charter decision in an unregulated environment. It does not compare this case with the case where investor rights are provided by law.

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charters should offer a higher degree of investor protection in more stable and mature industries (i.e. when the emergence of new unexpected business opportunities is less likely, and therefore the cost of missing opportunities is low), when the expected return of the investment is low (otherwise the participation constraint will not be satisfied), when the probability of tunnelling or expropriation by insiders is higher and when ex-post monitoring by investors is too costly or when punishments are not enforceable. In section 4, I attempt to examine these predictions using 19th century Chilean data.

3. CORPORATE LAW AND CORPORATIONS IN 19TH CENTURY CHILE

3.1. Corporate Law

Chile's first corporate law was approved by Congress in 1854[5]. The law was strongly influenced by the legislation of continental Europe and was drafted in response to demands for an adequate legislation by the Chilean business community (Brahm 1997) and to solve the situation of share companies organised during the 1850s whose legal status was unclear under the Chilean legislation[6].

The corporate law of 1854 was short and straightforward. It defined a corporation as a legal person formed by a common fund divided into shares. The shareholders had limited liability. As was the case in the rest of Latin America at the time, most of the regulations present in modern corporate law were left to be decided by the charters of each firm. Nothing was said regarding the composition of the board of directors, the requirements for being a director and whether directors were paid by the firm or not. There was no mention of voting rules, whether shareholders had the right to be represented by someone else at a shareholders' meeting, or if they had the right to call an extraordinary meeting. The only reference to governance matters was that no director could be appointed for life; rather directors should serve for specific terms that could be renewed by the shareholders.

According to the law, corporate charters must include:

- Name, occupation and address of the founding members.
- Location of the headquarters of the company.
- The objective of the company.
- Capital and number of shares, and the way and time at which the shareholders must complete their contributions.
- Lifespan of the company.

[5] *Ley de Sociedades Anónimas*, November 8, 1854.

[6] Until 1854 Chilean business organisation was still regulated by the Bilbao Ordinances, a Spanish legal body from the colonial period. In terms of organisational choices, the Bilbao Ordinances only recognised the simple partnership (*contrato de sociedad simple*) and the limited partnerships (*contrato de sociedad en comandita*).

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- Functions of the administrators and of the general assembly of shareholders.
- The capital deficit that causes the liquidation of the company and the procedure of dissolution.

Any breach of the charters could lead to the dissolution of the corporation, and managers and shareholders responsible for a contract violation could be sued for the damage caused.

All corporations had to publish a balance sheet every 6 months. Shareholders could only have access to the books of the company at the times and in the ways prescribed by the charters of the firm.

A corporation could be created only with a special licence from the executive branch of the government; this authorisation was also necessary in the case of modification of the charter or dissolution of the company. This was a common requirement in continental Europe at the time the law was passed and was also adopted in Latin America.

The authorisation process had two parts: first, the organisers had to submit the proposal of the charter of the corporation and a list of the founding shareholders and their contributions (at least one-third of the shares must have been previously subscribed by this time). The proposal was then evaluated by the Judiciary Supreme Court, whose role was to make sure that the charter was written according to law. Once the proposal was approved the entrepreneurs were given the authorisation to organise the firm. Once this process was completed, a second authorisation allowed the company to start its operations[7].

It is interesting to note that the law established that among the causes for rejection was the case where the charter did not offer shareholders «guarantees of a good administration, mechanisms to monitor the behavior of managers and rights to know the use of corporate funds». Given the fact that government officials could reject corporate charters, it raises the possibility that the authorisation process was used to filter out corporations that did not offer enough rights to their shareholders. I argue that this was not the case in Chile.

The reports of the Ministry of Finance and the Chilean Supreme Court reveal that government officials rarely raised objections regarding the governance provisions included in the charters, and the analysis of the charters shows that there were cases in different industries when a corporation was approved without including any rights for minority shareholders. Most of the objections raised by the judiciary are related to formal aspects and internal consistency of the charters[8], and on the rare occasions where the Supreme Court questioned

[7] For the companies created in Santiago and Valparaíso the average time span between the constitution of the company and first authorisation was 76 days (123 days for the rest of the country).

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the internal governance of the firm, their recommendations were not necessarily followed by the executive officials. A telling example is the case of the «*Gran Compañía Arturo Prat*», a nitrate company established in 1882 with a fully paid capital of one million pesos represented by its mining properties. According to the report of the Supreme Court the valuation of these properties was far above the real market price. The report suggested denying the government authorisation arguing that it should be the government's responsibility to protect investors from potential fraudulent companies. The official answer of the Ministry of Finance was the following: «It is not the responsibility of the government to qualify the «fair price» of the mines that are exploited by corporations, but only to judge that their charters comply with the law». The charter of the company was approved without modifications[9].

Moreover, it is important to notice that the law allowed a close substitute of the corporation: the limited partnership with tradable shares («*Sociedad en Comandita por acciones*» (LPTS)). An LPTS was formed between one or more general partners, who managed the firm and were fully liable for its obligations, and one or more limited partners with limited liability and no managing rights. The LPTS allowed entrepreneurs to raise capital from outside investors who had both the benefits of limited liability and liquidity, thereby providing a close substitute to the investment in corporate stock[10]. The LPTS was used as a substitute for corporations in continental Europe before general incorporation was available. In Chile, this organisational form was included in the 1865 Commercial Code (with a statute that closely followed the French law of 1846). However, it was rarely used by Chilean entrepreneurs (Cruchaga 1929), suggesting that the obstacles to obtaining a corporate licence were not that high and that entrepreneurs organising a corporation in Chile during the 19th century had plenty of freedom to choose the governance agreements best suited to their objectives.

The law also allowed the government to designate a special public auditor (*comisario*), to monitor corporate managers and their compliance with the law and charters of the company.

Did these government agents provide indirect protection to investors? The evidence provided by the «Directions for public auditors» (1887) suggests that this was not the case[11]. The description of the functions of these agents seems to be only related with banking activities: «check the monthly financial statement of banks, certify their account balances, and verify that the firm complied with the procedures established in the law». For non-financial

[8] For example, some charters were initially rejected because they did not include the legal address of the company (*Sociedad Minera el Morado*, 1899), the name of the initial subscribers, or failed to specify the lifespan of the company (*Minera de Batuco*, 1884).

[9] *Boletín de las Leyes*, Vol. LI, pp. 935–974 (1882).

[10] See Lamoreaux and Rosenthal (2005) for a detailed discussion of the advantages and disadvantages of the different organisational forms available in civil law countries.

[11] Decree of the Ministry of Finance, 21/4/1887.

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companies the role of the public auditors was restricted to tax-collection-related activities.

The law remained virtually unmodified throughout the 19th century. More detailed regulations of corporate matters were enacted during the 19th century in Europe and also in some Latin American countries such as Argentina, Mexico and Venezuela (Pistor *et al.* 2002). Although legal scholars and editorialists of the time proposed modifications in Chile[12], there were no significant changes of the governance rules until 1918[13].

3.2. Corporations Chartered in Chile 1854-1902

Five hundred and seventy-three corporations were created in Chile from 1854 to 1902[14]. Table 1 presents the corporations created during this period and the capital subscribed.

The introduction of corporate organisational form in the Chilean business community was slow and corporations accounted for <5 per cent of the total firms created in Valparaíso between 1854 and 1870 (Cavieres 1984). The creation of corporations really took off after 1870. Two factors account for this change: (1) the growth of the banking system after the banking law of 1860, which gave investors easier access to credit; and (2) the discovery of silver deposits in Caracoles, Bolivia, in 1870. Seventy-five companies were established between 1871 and 1873 to exploit these deposits and also to exploit nitrate in Tarapacá, Peru[15]. During these years there was also increased activity in other sectors (including finance and manufacturing) and in the participation of investors: the average number of initial subscribers rose from 26.3 before 1871 to 34.7 during 1871-1873. Investing in stocks, until then a concern for a very small minority, became a much more common activity: teachers, public employees and artisans appear in the lists of subscribing shareholders. After 1871, stock price quotations appeared regularly in the main newspapers of Santiago and Valparaíso[16].

The decline in terms of trade led to a recession during the second half of the 1870s, which had an immediate impact on the number of incorporations. Only thirteen new corporations were chartered from 1875 to 1880 and most of the silver companies in Caracoles were liquidated. In 1879, a dispute over

[12] Barrios (1899), Cofre Silva (1906), Cruchaga (1886), see also «*Revista Económica*» (1882).

[13] Minor reforms were enacted in 1878 and 1887.

[14] By way of comparison, from 1807 to 1867 (the year that general incorporation was introduced in France), the French government approved fewer than 700 charters (Freedeman 1979).

[15] It is worth noting that nearly all the mining companies formed in this period were operating outside Chile.

[16] Santiago (the capital) and Valparaíso (the main port) were the main commercial centres at the time. See Couyoumdjian *et al.* (1992) for a history of the development of the Santiago stock market.

TABLE 1
CORPORATIONS CHARTERED 1854-1902

	Companies	Capital (£)	Capital/GDP (%)
1854-1860	10	1,692,404	0.42
1861-1865	13	2,128,304	0.72
1866-1870	24	6,020,992	2.09
1871-1875	129	15,614,971	4.40
1876-1880	13	2,499,799	0.60
1881-1885	76	3,002,333	0.99
1886-1890	108	6,300,922	2.76
1893-1895	85	6,767,334	5.15
1896-1900	35	2,205,024	1.67
1901-1902	80	3,735,000	1.95
Total	573	49,917,083	

Source: Own elaboration, based on *Boletín de las leyes y decretos del Gobierno* and Braun *et al.* (2000).

the control of the mining resources in the Atacama Desert led to a war between Chile and a coalition between Peru and Bolivia (*War of the Pacific*).

At the end of the war (1882), Chile took control of the mining-rich territories of Tarapacá and Antofagasta. The wealth generated from the nitrate mines in the newly-annexed territories spurred economic growth and increased both the interest of investors and the number of companies created[17]. As had been the case during the silver boom in Caracoles during the previous decade, discoveries of new minerals and fluctuations in international prices led to cyclical stock market booms during the 1880s.

In the last decade of the 19th century, there was an increase in the number of banks and insurance companies. Also, the manufacturing industry that had started to develop before the war in small establishments grew in size, leading to the creation of larger companies that adopted the corporate organisational form in industries such as beer, tobacco and sugar refining.

During most of the period, stock trade was conducted by brokers in their own offices or in informal saloon meetings twice a week. The first attempts to create a formal stock market were made during the 1872-1873 boom, but none of them lasted beyond 1875. In 1892, the Santiago stock exchange was created with forty registered brokers, followed by the Valparaíso stock exchange in 1895. The majority of the corporations were chartered and based

[17] However, most of the nitrate companies were controlled by British investors.

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TABLE 2
CORPORATIONS PER ECONOMIC ACTIVITY

	Companies	Subscribed capital (£)
Mining	224	14,069,479
Manufacturing	68	3,263,316
Finance	93	25,114,037
Maritime	40	2,581,359
Utilities	35	873,561
Transportation	44	2,300,089
Others	69	1,715,242
Total	573	49,917,083

Source: Own elaboration, based on *Boletín de las leyes y decretos del Gobierno*.

in Santiago and Valparaíso even though mining activities were located either in the northern provinces (copper, silver and nitrate) or in the south (coal). The same is true for railroads (most of them were associated with mining activities) and some of the public utility companies.

Table 2 shows the number of corporations and total capital subscribed by economic activity. I classify economic activities in six main sectors: Mining, Manufacturing, Financial Services, Maritime, Utilities, Railroads and Others (Retail, Construction Companies, Agriculture and Forestry, Racetracks and Hotels). From the table it is apparent that mining (silver, copper, gold and nitrate) and finance (banks and insurance companies) were the most important sectors both in terms of capital subscribed and in number of firms.

Table 3 shows the market size in December 1902. Market size with respect to GDP was around 15 per cent. This figure is comparable with other Latin American countries and lower than European countries at the same time. However, in terms of the number of firms per million people, Chile compares favourably to other countries at the same time.

To summarise, the evidence introduced in this section shows that the lack of formal legal protection was not an obstacle to the use of the corporate form by Chilean entrepreneurs or the development of a stock market in Chile during the 19th century, suggesting that legal protection is not a necessary condition for the development of financial markets. In the next section, I attempt to answer the following questions: Do charters provide outside investors with rights and guarantees that were absent in the law? Do the contractual provisions included in the charters reflect systematic differences between firms as predicted by the agency model?

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TABLE 3
PAID CAPITAL PER ECONOMIC ACTIVITY 1902

	1902	
	Companies	**Paid capital (£)**
Mining	47	4,544,224
Manufacturing	27	1,629,023
Finance	55	3,498,903
Maritime	12	598,641
Utilities	24	466,234
Transportation	21	559,905
Other	20	181,143
Total	206	11,478,072
Capital/GDP		15.6%

Source: Own elaboration, based on *Boletín de las leyes y decretos del Gobierno* and Anuario Wessel.

4. EMPIRICAL ANALYSIS OF CORPORATE CHARTERS

The corporate charter (*estatuto*) is the contract that specifies the internal governance mechanisms of a firm and the rights and duties of the different stakeholders. As previously explained, Chilean corporate law gave the organisers of a corporation freedom to choose any governance regime and minority investor rights.

Since corporations required a government authorisation, each charter was approved by a special decree of the Ministry of Finance that was published in the «Bulletin of Laws and Decrees of the Government»[18]. Using government decrees, I collected the charters of Chilean corporations created from 1854 to 1902. The database includes 549 charters representing 95.8 per cent of the corporations created during the period. The law also established that government approval was necessary for any charter modification or liquidation of a company. I collected the details of 185 charter reforms and 124 liquidations.

In 471 cases (83 per cent) the company charter published in the Bulletin of Laws and Decrees also included names of the initial investors and the number of shares subscribed by each of them.

The analysis is conducted as follows: I start with a description of the ownership structure, followed by an analysis of the articles regarding voting

[18] From 1877 onwards the charters were also published in the daily official gazette.

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TABLE 4
OWNERSHIP STRUCTURE PER ECONOMIC ACTIVITY

	Shareholders (mean)	Stake held by largest shareholder (%)	Minimum number for majority control	Use of beneficial shares (% of firms)
Mining	32.5	26.7	4.4	59
Manufacturing	39.7	26.8	5.7	45
Finance	88.5	9.6	14.5	2
Maritime	42.5	20.4	6.3	16
Utilities	42.3	23.5	6.0	32
Transportation	47.8	20.7	8.1	38
Others	60.0	14.6	13.8	18
Total	47.1	22.1	7.1	37.5

Source: Own elaboration, based on *Boletín de las leyes y decretos del Gobierno*.

rights and shareholders meetings. Then, I describe the governance rules and the distribution of power among the board of directors, the shareholders' assembly, and managerial strata of the company. Finally, I discuss the evidence regarding charter modifications.

4.1. Ownership Structure

Since the seminal study of Berle and Means (1932), ownership concentration in corporations has been the subject of constant attention of academicians and policy makers. Available evidence shows that high levels of ownership concentration are frequent outside the United Kingdom and the United States, and Chile is no exception (see Morck *et al*. 2005).

Table 4 presents statistics regarding ownership concentration. The data indicate that, at the time of its incorporation, the average number of shareholders of a firm was forty-seven. On average, the five largest shareholders (C5) held 48.2 per cent of the stock. The ownership concentration level is lower than today's Chile, where C5 is nearly 80 per cent. These results are similar to other country level studies for the same period[19].

The average number of shareholders needed to hold a majority was seven[20]. Large shareholders were also present in companies with a significant number

[19] See Franks *et al*. (2006) for the case of Germany and Franks *et al*. (2007) for the case of Japan.

[20] This figure does not consider the effects of voting rules, given that voting scales and maximum voting limits were common during the period, the actual number required is higher.

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of investors, showing that minority investors were willing to participate in companies even in the presence of block concentration.

Both in terms of number of shareholders and the largest stake, ownership concentration was higher in the mining and manufacturing sectors. A common practice was to divide the shares between «contributive» shares (i.e. shares that were paid in cash) and «beneficial» shares (shares paid in services or kind). Two hundred and six companies (37.5 per cent)[21] used this mechanism, most frequently in mining (59 per cent), usually as compensation for the value of mining properties; and in manufacturing (44.6 per cent), as payment for exclusive privileges or patents. Only eleven companies (5.3 per cent) that divided their capital between beneficial and contributive shares also assigned different voting rights to each type of share. Whenever different rights were used, beneficial shares had fewer voting rights than contributive ones. Since beneficial shares were usually allocated to the organisers of the company, this shows that insiders did not allocate themselves any special voting rights (even though the law allowed them to do so), on the contrary, in some cases they were willing to restrict their voting power in order to attract outside investors.

4.2. Shareholders' Meetings and Voting Rights

Chilean law established that «Shareholders' assembly will meet regularly to analyze the situation of the company, modify the charter and decide in any matter of common interest to the shareholders». Most charters established two ordinary shareholders' meetings per year on preset dates. The board of directors was required to publish both the place and time of the meeting in the press.

Regarding extraordinary meetings, the law gave the board the right to call a meeting «whenever it is in the interest of the company» but made no reference to the rights of shareholders to do so without consent of the board. Nearly all (99.3 per cent) charters included articles regarding extraordinary meetings and 96.9 per cent of them allowed shareholders to call a meeting. Each company set up a requirement based on a certain number of shareholders (221 companies, 40.3 per cent) or a certain percentage of shares (477 companies, 86.9 per cent). 45.2 per cent of the companies with a percentage of shares-based requirement allowed the shareholders to call an extraordinary meeting with 10 per cent or less of the shares.

The literature has identified voting rights as an important element in the corporate governance of a firm. Contemporary studies have shown that the use of different voting rights per share is related to minority oppression. In the original study of La Porta *et al.*, the use of a law mandated one share-one vote (1s1v) rule is identified as one of the factors correlated with financial development.

[21] All percentages are calculated using the number of charters available (549) instead of the number of corporations.

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TABLE 5
VOTING RULES PER ECONOMIC ACTIVITY

	1s1v (% of firms)	Voting scale (% of firms)	Maximum vote provision (% of firms)	Average maximum vote (%)	Index of voting rights (V) (%)
Mining	24.3	4.5	67.6	14.6	42
Manufacturing	26.2	4.6	69.2	15.5	41
Finance	10.6	10.6	76.5	7.7	29
Maritime	10.5	23.7	84.2	16.8	29
Utilities	11.8	17.6	73.5	15.0	37
Transportation	15.0	27.5	80.0	14.6	29
Others	33.8	3.1	58.5	15.3	50
Total	21.1	9.1	70.5	13.8	42

Source: Own elaboration, based on *Boletín de las leyes y decretos del Gobierno*.

In Chilean corporations, the use of different voting rights per share was uncommon (and, contrary to contemporary practice, tended to favour minority investors). Also relatively uncommon was the use of a pure 1s1v voting system. Only 21.1 per cent of companies had such a voting system.

While current financial literature identifies 1s1v as a pro-investor voting regime, it is not the case of Chile during the 19th century. Most Chilean corporations had some type of restriction on the maximum amount of votes per shareholder. Three hundred and eighty-seven companies (70.5 per cent) had a ceiling on the maximum amount of votes that a shareholder could cast (including own and proxy shares). The average cap was 13.8 per cent. In 330 of these firms, the maximum vote was binding; therefore, the majority of firms had contractual provisions that were effectively curtailing the voting power of the largest shareholder.

Another voting scheme used during the 19th century was the graduated voting scale. A voting scale is a system in which the ratio of vote to shares decreases with the number of shares, and is usually complemented with some kind of maximum vote provision (Dunlavy 2004). Fifty companies (9.1 per cent) had a graduated voting scale; this mechanism was more frequent before 1875.

Both maximum vote provisions and graduated voting scales dilute the power of the majority shareholders and consequently increase the power of minority investors. Table 5 summarises voting rules per economic activity.

To study the differences in voting rules across firms I use a linear regression model. The dependent variable is the index of voting rights (Hilt 2008).

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This index captures both the effect of maximum vote provisions and voting scales in the same measure. The index is defined as follows:

$$V_i = \frac{1}{N}\sum_{n=1}^{N}\frac{v_i(n)}{n}$$

where N is the total numbers of shares and $v(n)$ is number of votes that a shareholder owning (or representing) n shares is entitled to. The index goes from 0 to 1, where values closer to zero mean that the voting power of large shareholders is more curtailed by the restrictions.

Table 6 presents the results of different specifications of a regression model with the index of voting rights as the dependent variable. The independent variables include capital, dummies for economic activity, use of beneficial shares, time trend and a dummy variable (location) to indicate cases when the productive activities were located far from the company investors (e.g. a water company chartered in Santiago to provide services in another town). This variable can be understood as a proxy for higher monitoring costs.

The coefficient for beneficial shares is negative and significant in all cases. As beneficial shares were usually distributed among the organisers of the firm, a negative coefficient means that organisers were more willing to restrict their voting power when their contributions to the firm were made in kind. The dummy for geographical separation between investors and the operations of the firm is negative and significant, meaning that voting rules that favoured minority investors were more frequently used in cases where monitoring was more costly. The economic activity dummies are negative in most cases (the base category is «others»). Capital is only significant in the first specification, which does not include the dummies for economic activity.

The limitations to the voting rights of the majority decreased for incorporations after 1880. This result is in line with the increased use of 1s1v in Europe and the United States at the same time. However, 67 per cent of the companies chartered after 1880 had restrictions to the voting power of the majority.

4.3. Governance: Assembly, Board of Directors and Managers' Attributions

Most firm charters identified three main groups of stakeholders with decision rights within the firm: the shareholders' assembly, the board of directors and managers. Charters also included provisions that regulated the administration of the business[22]. The degree of detail of these provisions and

[22] Some of them were industry related: bank charters, for example, included provisions regarding interest rates; insurance companies' charters regulate the type and maximum value of

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TABLE 6
REGRESSION RESULTS: DEPENDENT VARIABLE VOTING RIGHTS

	(1)	(2)	(3)	(4)
Paid capital	−0.0191*	−0.00671	0.00212	−0.00188
	(0.0114)	(0.0129)	(0.0130)	(0.0132)
Beneficial shares	−0.0524	−0.0733*	−0.0766*	−0.0656
	(0.0365)	(0.0400)	(0.0395)	(0.0399)
Year>1880	0.119***	0.123***	0.0765*	
	(0.0375)	(0.0379)	(0.0394)	
Location			−0.180***	−0.153***
			(0.0476)	(0.0488)
Mining		−0.109*	−0.0162	−0.00657
		(0.0652)	(0.0690)	(0.0705)
Manufacturing		−0.147*	−0.143*	−0.142*
		(0.0758)	(0.0749)	(0.0756)
Finance		−0.219***	−0.254***	−0.244***
		(0.0808)	(0.0802)	(0.0813)
Maritime		−0.277***	−0.283***	−0.272***
		(0.0883)	(0.0872)	(0.0887)
Transportation		−0.263***	−0.250***	−0.243***
		(0.0846)	(0.0835)	(0.0865)
Utilities		−0.197**	−0.142	−0.146
		(0.0906)	(0.0906)	(0.0916)
Time dummies	No	No	No	Yes
Observations	513	513	513	513
R^2	0.027	0.060	0.086	0.106

*Significant at 10%, **significant at 5%, ***significant at 1%.
Source: Own elaboration, based on *Boletín de las leyes y decretos del Gobierno*.

(F'note continued)
insurance policies; railroads and maritime companies' charters included freight rates. Also common was the inclusion of non-pecuniary benefits to shareholders, such as special rates or prices on services offered by the firm (in utilities, railroads and maritime companies) or priority to access certain benefits.

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of the description of the attributions of the board of directors and the shareholders' assembly varied greatly across firms.

Board members were chosen at the shareholders' assembly for a period between one and three years. In 526 companies (96 per cent), the charter established that in order to be a member of the board it was necessary to be a shareholder, and in 65 per cent of the companies it required a minimum amount of shares. Even though this requirement was usually low (<1 per cent of the stock on average), those who sat on the board were usually majority shareholders. Of the 330 companies for which information regarding the composition of the first board of directors is available, board members accounted for 32 per cent of the stock.

The possibility of recalling directors was included in 198 companies (38.6 per cent). The average percentage of votes required to recall one or more director was 59 per cent. This contractual clause was more frequently used in corporations chartered after 1881 (47 per cent from 1881 to 1902, 15 per cent before (t-test = 8.46) and in financial services (54 per cent).

Charters also enumerated the main functions of the board. The degree of detail of the descriptions of functions varied across companies. One important aspect of corporate governance revealed by this analysis of the functions of boards is that Chilean corporations conceived the board not solely as a supervisor of management but also as an agent with a strong role in conducting the business of the firm. In 81.1 per cent of firms, the charter defined as a function of the board either «to manage the firm» or to «conclude contracts» or to «decide in all matters related to business». When not restricted by the shareholders' assembly, it was the board of directors, and not the manager, who decided on all purchases, sales or mortgages.

The board was in charge of appointing and removing the manager (in only one case was the manager appointed by the shareholders' assembly). Most charters defined the manager as a paid employee in charge of the daily operations of the firm and of taking charge of the accounting books[23], and clearly subordinated the manager to the authority of the board. In 60.4 per cent of the charters the first obligation of the manager was to «execute all board agreements». No company gave the manager the power to sell or mortgage assets and, in the majority of cases (91.6 per cent), managers were also restricted by the board in hiring and firing employees.

Since managers had limited power regarding strategic decisions and in the majority of cases important decisions required the authorisation of the board, the following analysis focuses on the balance of power between the board of directors and the shareholders' assembly. For the Chilean case, given that founders and majority shareholders were usually sitting on

[23] The payment mechanism is usually left open. In some cases the charter explicitly authorised the board to use profit-based contracts.

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the board, the assembly-board relation is also closer to the theoretical entrepreneur-investor relation analysed in the model introduced in section 2.

Given that the degree of detail of the charters varies greatly, in order to analyse the balance of power between the shareholders' assembly and the board of directors, I used as the variable of analysis the right to decide to sell assets or to mortgage assets above a given size or considered fundamental for the operation of the firm, which is assigned in 89 per cent of the corporate charters.

The model suggests that this right should be allocated to the shareholders' assembly when the direct monitoring costs are high, when delay costs are low and when extraction costs are high.

In corporate governance, binary choice models are used to study the determinants of use of anti-takeover and other contractual rules (Bhagat and Jefferis 2002). In order to make good the definition I use the following criteria: Shareholders had the right to mortgage a specific asset if the board faced restrictions on selling or mortgaging any asset, on selling or mortgaging some specific assets or restrictions on selling or mortgaging assets that accounted for more than 10 per cent of total capital. In 264 charters (54.2 per cent), this right was allocated to the board of directors; in 223 cases (45.8 per cent), the charter established that the assembly had to approve any significant transaction. The assembly was given this power most frequently in mining (63 per cent). On the contrary, in 85.1 per cent of the financial companies, the board of directors had unrestricted power to make these decisions.

Table 7 presents the results of a probit regression using the right to sell or mortgage assets as the dependent variable with a value 1 for the cases where the assembly had veto powers regarding sale or mortgage of a critical asset. The explanatory variables are: paid capital, location dummy, use of beneficial shares, dummies for time period, economic activity and place of incorporation.

For ease of exposition, I present the marginal effects of the variables on the probability of having a pro-minority voting regime instead of the direct probit coefficients. Marginal effects are evaluated at the mean of the independents variables. In the case of dichotomic variables the table reports the effect of a change from 0 to 1.

Paid capital is non-significant in the first specification, but positive (and statistically significant) in the second and third specifications when the dummies for economic activities are added. The location dummy is significant in all specifications; the value of the coefficient is between 0.2 and 0.3, meaning that companies where investors were located far from the operations of the company were between 20 per cent and 30 per cent more probable to give more attributions to the shareholders assembly. Both results are consistent with the prediction of the agency model. The dummies for Santiago and Valparaíso are not significant. The dummy for the mining sector is positive and significant when the location dummy is not included

TABLE 7
PROBIT REGRESSION RESULTS: DEPENDENT VARIABLE VOTING RIGHTS

	(1)	(2)	(3)	(4)
Paid capital	−0.009	0.032	0.031	0.033
	(0.59)	(1.80)*	(1.61)	(1.70)*
Beneficial shares	−0.137		−0.079	−0.089
	(2.64)***		(1.43)	(1.59)
Year >1880	0.115	0.047	0.079	
	(2.16)**	(0.9)	(1.4)	
Location	0.315		0.223	0.194
	(6.19)***		(2.89)***	(2.43)**
Santiago			−0.095	−0.092
			(1.19)	(1.14)
Valparaíso			−0.117	−0.111
			(1.52)	(1.42)
Mining		0.204	0.072	0.079
		(2.48)**	(0.75)	(0.79)
Manufacturing		0.128	0.139	0.136
		(1.27)	(1.36)	(1.31)
Finance		−0.369	−0.351	−0.356
		(3.78)***	(3.45)***	(3.47)***
Maritime		−0.284	−0.271	−0.272
		(2.49)**	(2.23)**	(2.22)**
Transportation		0.037	0.003	0.005
		(0.32)	(0.03)	(0.04)
Utilities		0.067	0.056	0.043
		(0.58)	(0.47)	(0.35)
Time dummies	No	No	No	Yes
Observations	488	488	488	488
Pseudo R^2	0.06	0.12	0.14	0.15
Likelihood Ratio Test χ^2	43.48	81.2	93.43	98.39

*Significant at 10%, **significant at 5%, ***significant at 1%.
Source: Own elaboration, based on *Boletín de las leyes y decretos del Gobierno*.

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but its coefficient is close to 0 and non-significant when controlling by the location dummy. On the contrary, the dummy for the financial sector is negative in all specifications; this result is probably due to the fact that the right to veto sale or mortgage physical assets is less valuable in financial companies compared with the rest of the economic activities.

The dummy for incorporations after 1880 is positive, implying that the use of veto powers increased over time suggesting more concerns of the investors after the boom and crash of 1873. Notice that this is the exact opposite of the evolution of the pro-minority voting rules, suggesting that maximum vote restrictions and veto rights for the shareholders' assembly were used as substitutes regarding its role as investor protection tools. This is further explored in the following section.

4.4. Factor Analysis

Factor analysis is a statistical method that makes it possible to detect patterns in a set of interval-level variables, all of which are treated as dependent. In the context of this investigation, the variables are the different contractual clauses used in corporate charters.

The methodology closely follows Danielson and Karpoff (1998). I analyse ten governance provisions and assign the value of 1 whenever this provision is defined in the corporate charter in a way that favours the minority investors and 0 if it is not. Provisions include, among others, voting rights, attributions of the assembly and board of directors, election of the board of directors, requirements to be a board member and dispute resolution mechanisms.

Table 8 presents a detailed definition of the ten provisions included in the analysis. Provisions defined in a sufficiently large number of charters were chosen, which makes it possible to compute the underlying factors (the results below are based on 367 companies for which is possible to compute all ten variables).

For each of the contractual provisions I run auxiliary regressions using the provision as the dependent variable and dummies for economic activities and five-year period dummies as explanatory variables. I compute the factor analysis using the residuals of these regressions. This method allows me to exclude the long time span of the data and differences between economic activities as sources of variation. The three factors with eigenvalues >1 are retained. Results are presented after a varimax rotation and are summarised in Table 9.

The table shows that several provisions are observed together. The first factor is loaded with governance provisions related to ex-post control (calling extraordinary meetings, recalling directors) and the process of election of directors. The second factor is loaded with ex-ante mechanisms, such as

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TABLE 8
CORPORATE PROVISIONS INCLUDED IN FACTOR ANALYSIS

Variable	Definition
Extraordinary meeting	1 if it is possible to call an extraordinary meeting with <15% of the total shares and fewer than ten shareholders
Maximum vote	1 if there is a maximum corresponding to 15% or less of the total shares
Free representation	1 if a shareholder can be represented by some other person at a shareholder meeting by letter addressed to the president of the meeting, without notarised power of attorney
No related persons	1 if two related persons or partners cannot serve at the same time in the board of directors
Recall	1 if the charter explicitly includes a mechanism to recall one or more members of the board of directors.
Mortgage	1 if decisions regarding the sale or mortgage of assets that represent more than 10% of the total assets or require assembly approval
Reform	1 if charter reforms require a supra-majority quorum of the assembly
Dissolution	1 if the shareholders' assembly takes charge of the company in case of dissolution
Audit committee	1 if the charter explicitly includes an audit committee
Arbitrage	1 if the charter explicitly includes arbitrage mechanisms

provisions regarding the shareholders' assembly having the explicit faculty to block some of the board's decisions (sale or mortgage of assets, charter reforms, dissolution of the company), and the third factor is related to auditing functions. In many provisions factors 1 and 2 are negatively related, suggesting that firms used ex-ante and ex-post systems of control as substitutes. This result is consistent with the agency model presented in section 2: the cost of providing ex-post or ex-ante protection differs for each firm, and therefore, each firm chooses the most cost-efficient mechanism to provide protection for their investors.

4.5. Charter Reforms

Any charter reform required the approval of the shareholders' assembly. Four hundred and thirty-nine charters (80 per cent) included specific rules and voting requirements regarding charter reform. The average percentage

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TABLE 9
FACTOR ANALYSIS RESULTS

Variable	Factor 1	Factor 2	Factor 3	Uniqueness
Extraordinary meeting	0.64	−0.32	0.01	0.49
Maximum vote	0.61	−0.06	0.51	0.36
Free representation	0.82	0.02	−0.25	0.27
No related persons	0.93	−0.03	0.15	0.12
Recall	0.37	−0.26	−0.10	0.78
Mortgage	−0.91	0.28	0.10	0.08
Reform	−0.03	0.58	0.12	0.65
Dissolution	−0.23	0.88	0.01	0.18
Arbitration	−0.03	0.13	0.82	0.31
Audit committee	−0.18	−0.36	0.55	0.54

Source: Own elaboration.

of approval required for charter reform was 60.6 per cent. After a charter reform was approved by the shareholders' assembly, it had to be submitted to the government for approval. Charter reforms were also published in the official bulletins. In 155 cases (from a total of 185), the government decree included details of the contents of the reform: the most common reform submitted for government approval was an increase of capital (45.2 per cent). Another frequent modification was on the definition of the scope of the firm's activities, for example, new policies for insurance companies, extension to mining activities by foundries or vice-versa or changes in the location of the company (22.7 per cent). Table 10 details the type of reforms and their frequency.

Governance rules were also subject to modifications. There were changes in voting rights (20 per cent), attributions of the board of directors, the number of members of the board and their term of office (19.4 per cent) and rules to call an extraordinary meeting (4.5 per cent). There is no clear direction to these changes: some companies modified their charters to impose more restrictions on maximum votes while others did so to introduce a 1s1v regime, some companies increased the power of their board of directors while others took attributions from them and gave them to the shareholders' assembly.

For the objectives of this paper, two interesting cases to consider are the reforms introduced by «*Compañía de Gatico*» and «*Compañía Industrial*». The former was a copper company established in 1900 with six subscribing shareholders, all of them belonging to the same family. The initial charter of

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TABLE 10
CHARTER MODIFICATIONS

Type of reform	Frequency (%)
Capital increase	45.2
Company activities	22.6
Changes in voting rights	20
Extension to the life-span of the corporation	11.6
Changes in board functions and number of directors	19.4
Rules to call an shareholder meeting	4.5
Changes in non-pecuniary shareholders' benefits	1.3
Changes in nominal value of shares	12.9

Source: Own elaboration, based on *Boletín de las leyes y decretos del Gobierno*.

the company had no mention of shareholder rights, no rules to designate the board and no clear distinction of the functions of the shareholders' assembly, the board of directors and management. Two years later, the company decided to increase its capital by issuing new shares to the general public. At the same time, the governance rules were modified, increasing the number of directors from three to five to be reelected annually, giving shareholders the right to call extraordinary meetings with 10 per cent of the shares and establishing a voting ceiling[24].

The case of «*Compañía Industrial*», a chemical company established in 1901, is an example of how governance rules were relevant from a minority investor perspective. In 1902 the majority shareholders (who controlled the majority of the board) decided to reduce the number of directors (thereby excluding representatives from minority investors), to elevate the percentage of shares required to call an extraordinary meeting to 60 per cent (at the time the directors of the company held more than 40 per cent themselves) and to establish a five-year term for board members (no other company charter approved from 1854 to 1902 had board terms longer than three years). A group of minority shareholders opposed the reform in the assembly meeting and later filed a complaint to the judiciary to block the reform. The complaint was dismissed by the courts on the grounds that the reform was approved by the number of votes required in the charter[25].

Both examples show that governance rules were relevant to investors. In the first case, the desire to obtain financing from outside investors made the

[24] *Diario Oficial*, 7178, p. 876, 1902.
[25] *Diario Oficial*, 3136, p. 7377, 1902.

owning family modify the governance rules, including investor rights that were absent in the original contract, while in the case of «*Compañía Industrial*» the minority investors who tried to block the reform of the company charters clearly understood that under the new rules they could be easily be subjects of expropriation by the firm's insiders.

5.. CONCLUDING REMARKS

This paper presents an analysis of the charters of Chilean corporations during the second half of the 19th century.

Even though Chile was far from the main economic centres of the time, during this period the Chilean economy was integrated with the rest of the world. The main economic activity was the export of natural resources. Chilean and foreign entrepreneurs frequently used corporations as a vehicle to raise capital to organise mining activities and also to develop the financial system, build railroads, provide basic services to the growing Chilean cities and finance the first steps of industrialisation.

The 19th century is also the period during which Chile, like the rest of Latin America, developed its legal and economic institutions. In the particular case of commercial law, the model followed in these countries was the civil law from continental Europe. The influential «law and finance» literature argues that countries with French legal origins have lower levels of investor and creditor protection, and that this lack of protection is one of the main causes of the financial underdevelopment in Latin America. This paper studies the case of Chile to show that the lack of investor protection provided by the law was not an impossible obstacle for Chilean entrepreneurs to raise funds and argues that private contracts (corporate charters) were used as a substitute for the lack of law-provided investor rights.

I collected the charters of 549 Chilean corporations and show that even though the law was silent regarding the rights of investors, firms' charters usually included among their provisions several mechanisms of investor protection: charters gave investors the right to summon extraordinary meetings, and often limited the influence of large shareholders by imposing limits on their voting power. In addition, charters allowed investors to form auditing groups as well as to be represented by someone else in meetings and to solve their differences with the managers and board by arbitration. All of these investor rights and check mechanisms were absent from corporate law at that time.

Chilean corporate charters also regulated the attributions of the board of directors and the shareholders' assembly, most of them defined the board of directors as the agent in charge of the administration of the firm, with the manager clearly in a subordinate position. At the same time, charters frequently imposed restrictions on the functions of the board, giving the shareholders' assembly important veto powers in strategic decisions.

The empirical analysis shows that the use of different provisions is consistent with the predictions of a simple principal-agent model. I find that shareholders' assemblies (and therefore minority investors) were given more decision-making power in companies when capital requirements were higher, when investors were located far from the productive activities of the firm and when there was a lack of alternative mechanisms to monitor.

The paper shows that firms can (and do) find substitutes to law-provided investor protection. Other authors are finding similar results in other civil law countries. Therefore, firm level analysis can help us to explain why the law and finance relation does not seem to hold at the end of the 19th century. The results of this paper (and all the related literature that has been emerging) argue in favour of the benefit of exploring the history of financial development and its political economy beyond the «legal origin» hypothesis, if we really want to understand what the main determinants of financial development are and how the least developed countries can take steps along this path.

As in the existing literature, I also use a country-level analysis approach. By focusing on Chile during the 19th century I leave two important questions which should be the focus of future research unanswered: (1) How similar is the Chilean case to the rest of Latin America? and (2) Why did Chile not continue along the path of financial development during the 20th century?

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