

Firm- and Country-level Determinants of Firm Value in Emerging Markets: A Corporate Governance Approach

Abstract

This study analyses the impact of firm-level variables as well as country-level institutional factors on the firm value. The theoretical framework used to develop the research hypotheses has followed a corporate governance approach. The sample includes public firms from Argentina, Brazil, Chile, Colombia, Mexico, and Peru for the period 1997-2013. The main findings indicate that the ownership concentration, the capital structure, and the dividend policy are important drivers of the market value of the firm. At the country-level determinants, results exhibit that the legal enforcement and regulatory system impact positively the market value of the firm in the Latin American context. Concerning the development of the financial system, the findings show unexpected results.

JEL Classification: G32

Key words: Corporate governance, firm value, emerging markets, LATAM

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1) Introduction

Mechanisms of corporate governance across emerging economies had manifested differently from those widely observed and analyzed in developed countries, and particularly in the USA (Claessens, Djankov, Fan, & Lang, 2002; Claessens & Yurtoglu, 2013; De Jong, Kabir, & Nguyen, 2008; Klapper & Love, 2004; Morey, Gottesman, Baker, & Godridge, 2009). Additionally, most of the papers have analyzed the corporate governance tools at the firm-level or at the country-level basis, but have not paid attention to the interacted impact of these two sources of governance on the firm value. Consequently, the major goal of this paper is to study how the internal and external corporate governance mechanisms impact the firm market value for a sample of emerging markets companies.

Among the firm-level corporate governance systems, it has been widely discussed in emerging economies that the ownership structure of their firms is characterized by high concentration with frequent use of dual class shares or pyramidal structures (Black, de Carvalho, & Gorga, 2010; Buchuk, Larrain, Muñoz, & Urzúa, 2014; Claessens, et al., 2002; Fariás, 2014; Khanna & Palepu, 2000; La Porta, Lopez-De-Silanes, & Shleifer, 1999). In this context, the expropriation problem of minority shareholders by the controlling shareholder seems to be more relevant than the conflict of interest between managers and shareholders (Dyck & Zingales, 2004; Jensen & Meckling, 1976; Shleifer & Vishny, 1997). Consequently, one of the specific goals of this work is to shed light on how this horizontal agency conflict is addressed in emerging markets.

In addition to this, we intent to study also the corporate governance through two alternative firm-level tools to control for the free cash flow problems, we mean the financial decisions and the dividend policy. Potential agency problems coming from free cash flows might be solved by reducing the funds available for discretionary opportunistic behavior. In that sense, the periodic amortizations of loans (principle and interest charge) leave fewer funds available for managerial discretion. Similar impact is caused by the dividend payment. Consequently, another specific goal of this paper is to study the impact of the leverage as well as the dividend policy on the market value.

On the side of the country-level governance systems and their impact on the firm value, just a few papers have also been developed for emerging markets (Chari, Ouimet, & Tesar, 2010; Gibson, 2003; Klapper & Love, 2004; López & Crisóstomo, 2010; Mitton, 2004; Morey, et al., 2009).

In addition to the major contributions of this paper, there are a number of limitations in the current empirical literature that we want to address somehow, for instance i) most of the papers do not address properly endogeneity problems (Balasubramanian, Black, & Khanna, 2010; Black, de Carvalho, & Gorga, 2012; Espinosa & Maquieira, 2010; Mitton, 2004), and therefore, any interpretation regarding causality must be considered cautiously; ii) other limitation of these works is enrooted either on the scope and/or on the scale. On the one hand, they intend to use samples of firms from different countries but they lack of representativeness for further extrapolation (some of this works are summarized in Table 1). On the other hand, they opt for using either firm-level or country-level determinants of firm value, but rarely both; which does not allow to verify

the interaction between the firm- and country-level factors (De Jong, et al., 2008; Morey, et al., 2009); and iii) some papers establish the relationship between corporate governance systems and firm market value from an intuitive more than theoretical point of view such as in Balasubramanian et al. (2010), lying bare causalities among the explanatory variables with no justification. Another example about it is in Silva et al. (2006) work. For instance, they develop a non linear model based on a cubic relation between ownership concentration and firm value; fact which does not have a clear theoretical support. All these limitations in the empirical literature leave on the air several unanswered questions.

Accordingly, the motivation of this work is to improve the current empirical literature on the efficiency of corporate governance mechanisms as determinants of the firm value, on the one hand; and in addressing some unanswered questions on corporate governance in the context of emerging economies, on the other hand. So, in this paper we intend to go further in the analysis by articulating a comprehensive set on the interplay of endogenous and exogenous determinants of the firm value.

The main findings indicate that at the firm-level determinants, the ownership concentration, capital structure, and dividend policy are important drivers of the firm value. At the country-level determinants of the firm value two important groups were considered: legal and regulatory systems and the development of the financial system. The findings indicate that enhancements in the legal and regulatory systems press up the market value of the firm. This finding is in line with Claessens and Yurtoglu (2013). However, contrary to what was expected, when the financial markets become more efficient in Latin America, the firm value declines.

The remaining of the paper goes as follows: section two describes the literature review and develops the research hypotheses. Section three articulates the methodology applied in the empirical analysis and describes the main variables and the sample of firms. In section four the main findings are summarized and finally, in section five, we breakdown the major conclusions and remarks.

2) Literature review and research hypotheses

There is no a single and all-embracing definition of corporate governance. The theoretical literature provides many definitions from different approaches. However, all of them are built upon two pillars. First, as a set of behavioral patterns, or in other words, the actual behavior of corporations in term of, for instance, the way they are managed or how the financial decisions are made, among others; and second, as a normative framework which defines the way firms are governed (Claessens & Yurtoglu, 2013). Nevertheless, in terms of the scope of this work, we will understand for corporate governance as the set of internally and externally generated mechanisms (e.g. norms, rules, procedures, policies, and institutions, among others) through which firms operate when ownership is separated from management in order to ensure the maximization of the shareholders' wealth.

a. Firm-level determinants

Jensen and Meckling (1976) argue that, because of the separation of ownership and control, managers have the propensity to engage in self-serving behavior such as perquisite consumption, empire building, and shirking of effort. The literature provides several governance mechanisms to alleviate agency conflicts between shareholders and managers as well as between majority and minority shareholders. The first conflict is usually defined as the vertical conflict of interests between the principal and the agent; whilst the second describes a horizontal conflict between shareholders (e.g. majority and minority). The first firm-level governance system to be analyzed is the role of the corporate ownership structure as a disciplining device.

i. Corporate ownership structure

The way in which the ownership is shared among the stockholders might alleviate or aggravate the agency problems. It has been widely argued that concentrated ownership structures solve some agency problems through direct supervision of managers (Ang, Cole, & Lin, 2000). This argument leads to a positive relationship between ownership concentration and firm value as posted by the monitoring hypothesis. Therefore, the vertical agency conflict between managers and shareholders might be efficiently reduced through a higher ownership concentration (Jensen & Meckling, 1976; Shleifer & Vishny, 1986). Nevertheless, a highly concentrated ownership structure might cause the firm value to reduce as highlighted by the expropriation hypothesis. The expropriation –also named the horizontal agency problem– occurs when controlling-majority shareholders use their decision power in their own best interest, which does not necessarily corresponds with that of minority shareholders (de Miguel, Pindado, & de la Torre, 2004, 2005). As a result, there is a redistribution of wealth from minority to majority shareholders. From this point of view, the expropriation hypothesis suggests a negative change in the market value when the ownership in hands of majority shareholders increases. On the one hand, the dominant shareholder has incentives to maintain weak internal controls in order to facilitate expropriation (Bozec & Bozec, 2007); and on the other hand, dispersion produces free-rider problems and wrong incentives on minority shareholders for monitoring (Bottazzi, Da Rin, & Hellmann, 2009). Consequently, firm value is deteriorated in presence of strong controlling shareholders and weak minority shareholders.

The way the ownership structure is shaped in the firms across countries depends also on the characteristics of the financial systems. The Law and Finance approach provides a sound argument for that (La Porta, et al., 1999; La Porta, Lopez-De-Silanes, Shleifer, & Vishny, 1998; R. La Porta, F. Lopez-de-Silanes, A. Shleifer, & R. Vishny, 2000; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2002). La Porta et al. (2002) argue that the higher protection of investors' rights in the common-law system allows shareholders to hold a lower proportion of the equity capital without risk of being expropriated. The opposite is evidenced in civil-law emerging economies where a concentrated ownership structure –as well as the internal corporate governance mechanisms– arises as a natural response to the lower protection to investor rights (Esty & Megginson, 2003; Gugler, Ivanova, & Zechner, 2014; Majluf, Abarca, Rodríguez, & Fuentes, 1998). For instance, the empirical work of Crisóstomo et al. (2014) shows that in financial systems where the rights of minority shareholders are poorly protected such as in Brazil, block ownership –comprised by nonfinancial firms– is able to reduce the intensity of financial constraints, and consequently increase the firm value. The arguments of Crisóstomo et

al. (2014) support therefore the monitoring hypothesis.¹ Briefly, we can state that the configuration of the corporate ownership structure as a governance device can be a double-edged sword which might improve or dilute the market value, depending on which is the dominating effect, either the monitoring hypothesis or the expropriation hypothesis.

H1: Therefore, we might expect a non-linear relationship between the ownership structure and the firm value supported by the monitoring and expropriation hypotheses.

ii. Capital structure decisions

Beyond the classical explanation of financing decisions based on the cost of external resources, on the asymmetric treatment of taxation or on the bankruptcy costs, there are several arguments that support the interaction between the capital structure and the conflicts of interests inside the firm, and therefore, the firm value. The first way in which the leverage influences the efficiency of firms comes from the use of debt as a control mechanism of managers (Barclay, Max, & Smith, 2003; Harris & Raviv, 1991). The preference of managers for the consumption of perks –overinvestment in the Jensen and Meckling (1976)'s words– at the expense of the shareholders' wealth is alleviated through more leveraged capital structures. In that sense, highly leveraged capital structures increase the firms' insolvency risk and the chance of losing the job for managers (Hunsaker, 1999; López & Saona, 2007). Consequently, managers will avoid such opportunistic behavior in favor of maximizing the interests of their current shareholders. The opposite situation is the underinvestment problem which is suffered when firm accounts with profitable investment opportunities but not enough cash flows. Under this scenario, firms are forced to just pass these profitable options. Nevertheless the use of debt allows firms to exercise these investment opportunities and increase the firm value.

The second way is determined by the restrictions imposed by the debt agreements on the use of the free cash-flows available for investing in projects with negative net present value (Jensen, 1986).² The availability of these resources might originate a conflict between shareholders and managers because the former will be willing to obtain a higher dividend pay-out; whilst the latter will prefer to keep them. Therefore, a way to reduce the free cash flow available for discretionary use might be by increasing the debt position and/or the dividend payout (which will be discussed in the next part).

The third characteristic of debt as a governance system is performed by the clauses of debt covenants.³ Rauh and Sufi (2010) suggest that when the creditors –e.g. banks–

¹ Crisóstomo et al. (2014) claim that nonfinancial firms as blockholders in Brazil bring more active management monitoring; reduce the likelihood of overinvestment; lower the change of managerial discretionary behavior; reduce the agency conflicts between ownership and control; and improve the information with financial markets. In that sense, Dyck and Zingales (2004) analyse the premium paid for control blocks in 37 countries. Their findings suggest that the premium is 27% for Argentina and Colombia, 65% for Brazil, 18% for Chile, 34% for Mexico, and 14% for Peru.

² The free cash flows are those available for the discretionary use of managers once the future growth opportunities with positive net present values have been financed.

³ Covenants are particular clauses in debt contracts of firms that restrict business policy, giving creditors the possibility of putting precise actions into force and enhancing their incentives to monitor (R. Rajan & Winton, 1995).

write tight covenants into loan agreements, the managerial opportunistic behavior is better monitored and the firm value increased.

Finally, a last way comes from the choice made by the controlling shareholder. In this case, Araya et al. (2015) have shown particularly for the Chilean context that the controlling shareholder might prefer to issue debt rather than new common equity, due that the new equity capital implies a certain loss of corporate power. Nevertheless, the debt issuance inhibits this risk.

Considering the arguments above, the role of capital structure is basically to identify whether this mechanism reduces the vertical conflicts of interest between managers and shareholders as well as between shareholders and creditors. Nevertheless, increasing the debt level indefinitely might not contribute indefinitely to the firm value. As suggested by the trade-off hypothesis, the firm must look for certain equilibrium due to the joint effect of debt tax benefits and bankruptcy costs. So, from the previous argument we can perform the following two hypotheses:

H2: Firms with more leveraged capital structures should exhibit better market values. This expected result is supported by the monitoring role played by creditors, the covenants included in the debt contracts, the short of the available free cash flow for opportunistic behavior, the higher insolvency risk due to high debt levels which in turn force managers to perform better, and the opportunity to finance projects with positive net present values.

H3: A nonlinear relationship might be expected between the firm value and the leverage. The firm value might increase as debt increases as a consequence of tax benefits but up to a certain point where the bankruptcy risk overwhelms the firm value and presses it down. This argument is supported by the trade-off hypothesis which suggests the estimation of an optimal debt level which maximizes the firm value.

iii. Dividend policy

Another financial decision that might be linked to the firm's value is the dividend policy. The dividend pay-out might play different roles in capital markets characterized by large gaps of information and serious market imperfections (R. La Porta, F. Lopez-De-Silanes, A. Shleifer, & R. W. Vishny, 2000; Setia-Atmaja, 2009) as is the case of countries with immature financial markets. In these contexts, the payout policy has an informative content into the capital markets about the future prospects of the firm (Brav, Graham, Harvey, & Michaely, 2005).

Consistent with the agency model, the dividend policy works as a disciplining device in two different ways. First, as pointed above, the dividend has the capacity to reduce the discretionary managerial behavior (Ferris, Sen, & Unlu, 2009) by lowering the free cash-flows and improving the firm value (Pindado & De La Torre, 2006). In their two periods model, Acharya et al. (2011) argue that this internal governance device can mitigate agency problems and ensure that firms have substantial value, even with little or entire lack of governance by investors. External governance, even if crude and uninformed, can complement internal governance and improve efficiency. So, according to the agency model, outside shareholders have a preference for dividend over retained earnings because insider might make suboptimal decisions by using the cash retained

within the firm (Mitton, 2004). Similarly, Bodnaruk and Östberg (2013) find that firms with small shareholder bases –ownership structures more concentrated– have lower payout level and maintain higher cash holdings. Second, according to López and Saona (2007) the pay-out policy improves the managerial supervision by incorporating the market as supervisor. According to this argument, when the firm pays for dividends periodically, the company is impelled to get external funds in the debt market for instance. Consequently, the participants in such market take a supervisory role on the lent funds by monitoring the performance of managers (Easterbrook, 1984). It is therefore expected that such tighter supervision impacts positively the market value.

The evidence on the interaction between dividend policy and governance structures comes also from cross-countries analyses where several studies document that the institutional and legal environments affect firms' payout policies. For instance, La Porta et al. (2000) report that firms in common-law countries pay higher dividends than those operating in civil-law countries where minority shareholders suffer from weaker legal protection. In fact, according to Mitton (2004), the preference for dividends may be stronger in emerging markets with weak investor protection if shareholders perceive a greater risk of expropriation by insiders in such countries. In the same line, for Japanese firms, He (2012) finds out that the dividend pay-out policy depends substantially on the capacity of the country's legal system to constrain both controlling shareholders and insiders to pay dividends to minority claimants (shareholders). Thus we cannot dissociate the nature of the dividend policy and the characteristics of the legal system across countries.

The dividend policy seems to be related not only with the firm value as a governance device, but also with the existence of future growth opportunities. La Porta, et al. (2000) find out that in countries with strong investor legal protection, there is a stronger negative relationship between growth opportunities and dividend policy. In other words, when investors perceive that the expropriation risk is low, they will be more willing to let the firm retain earnings for financing the future growth and get the payoffs from the projects' future returns later on. Conversely, when expropriation risk is high, investors will be willing to exercise the cash flow rights as soon as possible even if the firm accounts with growth opportunities.

Therefore, the previous arguments on how the dividend policy determines the firm value articulate our fourth hypothesis which suggests that:

H4: Dividends impact positively the firm market value. Nevertheless, such impact might be depending on how well the investors' rights are protected by legal system.

b. Country-level determinants

The country-level determinants correspond to those exogenous variables associated with corporate governance systems which impact the firm value. Demirgüç-Kunt et al. (2004) categorize these kind of variables in regulatory variables, macroeconomic and financial system control variables, and institutional variables. In term of the purpose of this work, we just categorize the country-level determinants of the firm value into legal and regulatory systems and financial development systems. These two groups of variables are considered in the analysis because it has been widely established that cross-country differences in laws and their enforcement affect ownership structure,

dividend policy, availability and cost of external finance, and the market valuation (La Porta, et al., 1999; La Porta, Lopez-de-Silanes, & Shleifer, 2002; La Porta, Lopez-de-Silanes, Shleifer, et al., 2002; Rafael La Porta, et al., 2000; Love, 2011). Claessens & Yurtoglu (2013) suggest that the current challenges of corporate governance are highly determined the development of both the financial markets and the legal systems. Since this work has adopted a corporate governance approach, we cannot dissociate these two groups of variables in the theoretical and empirical analysis.

i. Legal enforcement and regulatory system

Demirgüç-Kunt and Maksimovic (1998) and later on Demirgüç-Kunt et al. (2004) find that better legal enforcement and efficient regulatory systems are associated with lower levels of corruption which make the financial system to perform with much less frictions. Although focused on financial institutions only, Naceur and Omran (2011) study the influence of bank regulation and concentration on the value of Middle East and North Africa commercial banks. They find that regulatory and institutional variables seem to have an impact on bank performance. This implies that there is a positive association between legal enforcement and the efficiency of the regulatory system and firm value.

The legal and regulatory system involves a number of dimensions such as the root of the legal system; the general protection of property rights (particularly those of creditors and shareholders’); the enforcement of the law; lack of corruption; transparency and disclosure of information, among others. In cross-country analyses, many of these aspects are qualitative and consequently not easily captured and codified (Claessens & Yurtoglu, 2013). For almost fifty countries, La Porta et al. (2006) analyze the specific provisions in securities laws governing IPOs and examine the relationship between these provisions and various measures of stock market development. They find strong evidence that laws mandating disclosure and facilitating private enforcement through liability rules benefit stock markets. Similarly, Klock et al. (2005) study the relationship between the cost of debt and a governance index. Particularly, they find that strong (weak) antitakeover provisions are associated with a lower (higher) cost of debt financing which improves (worsens) the firm value.

Corporate governance can be seen as a dynamic phenomenon in conjunction with the firm operation. Consequently, it is required for a cross-sectional study to consider not only the legal enforcement but the corporate governance reforms that take place across time. Firms must adjust the way they do business according to the law and according to the changes in the law and legal systems (Iglesias, 1999-2000; La Porta, Lopez-De-Silanes, & Shleifer, 2008; Naceur & Omran, 2011).

H5: The better the regulatory and legal system across countries, the higher the market value of the firms will be.

ii. Financial development of capital markets

It has been widely accepted in the literature the positive influence of the development of a country’s financial sector on the level and growth rate of its per capita income (R. G. Rajan & Zingales, 1998). The role of financial institutions in capital markets is to serve

as a middleman between saving and borrowing units by reducing the transaction costs. The financial development enhances the allocation of capital, liquidity, the firms' access to more sophisticated financial instruments, the flows of information, and reduces the cost to external financing, better enabling firms to exploit current growth opportunities (Love, 2011). For a sample of developed and developing countries, Raddatz (2006), for instance, provide evidence that the financial development has a large causal effect in the reduction of macroeconomic volatility resulting from the role of the financial system in liquidity provision. Thus, higher financial development is translated into a greater number of real growth opportunities and positive net present value projects due to the lower cost of external financing.

When financial markets are not well developed, market anomalies and opportunistic behavior arises, impacting negatively the firm value. Lin and Tai (2013) provide empirical evidence of this. They report that analysts would recommend poorly governed firms to their clients in an emerging market where information asymmetry tends to be high and shareholder rights are not well protected by legal systems –low financial development. They also estate that the improved governance by developed financial systems not only reduces agency problems within firms, but also enhances information quality produced by analysts.

H6: More developed financial markets positively affect the firm value in emerging markets

3) Methodology, baseline model, and variables definition

a. Methodology

The empirical work will be done through panel data analysis, which is a combination of cross sectional and time series information. The panel data methodology allows to control for two typical problems in this kind of studies: the heterogeneity and the endogeneity problems (Manuel Arellano, 2002).

The interaction between the firms' characteristics and the country-level variables must be interpreted carefully because of the possibility of observing spurious relations which foster the endogeneity problems. An exogenous variable is that whose values are given and are not affected by the variable to be explained, which is said to be endogenous (Blundell & Bond, 1998). As argued by Love (2011), the question whether better governance leads to improved valuation might be driven also in the opposite direction, that is, better performance leads to better governance. She also suggests that better identification methods need to be developed in order to articulate convincing conclusions about the direction of the causality. Although we do not identify the causality direction since this is not the scope of this work, we at least apply an efficient econometric tool, named the GMM system estimator (SE), to deal with this endogeneity problem.⁴

In order to deal with these sources of endogeneity, we used the two-step SE with adjusted standard errors for potential heteroskedasticity as proposed by Blundell and Bond (1998). Originally, the Arellano and Bond (1991) estimator eliminates the individual fixed effects by transforming the regression in first difference and using

⁴ Love (2011) argues that neither the fixed-effect nor the instrumental variables techniques fully remove the possibility of time varying omitted variables and it does not address reverse causality.

GMM to estimate the parameters. The Arellano and Bover (1995) and Blundell and Bond (1998) estimator corresponds to an extension of the Arellano and Bond (1991) estimator, combining a system of regression in difference and still the ones proposed by Arellano and Bond (1991) in levels. In turn, the instrumental variables for the level regressions are composed by lags of the first-difference explanatory variables. Thus, under the assumption of stationarity of the panel, Blundell and Bond (1998) estimator is more efficient than the original Arellano and Bond (1991) estimator (Nguyen, Locke, & Reddy, 2014; Saona & Vallelado, 2014).

Since consistency depends on the orthogonality of the instruments, Sargan overidentification test to check for exogeneity of the instruments will be used. Given that Sargan statistic is not robust to heteroskedasticity and autocorrelation, Hansen test will be used since it is not subject to those drawbacks. The Hansen statistic follows a $\chi^2_{(q-k)}$ distribution with q number of moment conditions and k estimated parameters.

Regarding the autocorrelation, the test proposed by Arellano and Bond (1991) is applied to the first difference of the residuals, AR(1). Typically, the null hypothesis of no first-order correlation is not rejected.⁵ Therefore, one must also perform the test for second order autocorrelation, AR(2). No rejection of the null hypothesis indicates that the moment conditions are valid.

Two simultaneous equations are involved in system estimator approach. The first equation works in levels and the second equation is in first differences where the instruments are the variables (Bond, 2002; Wooldridge, 2002).

A dynamic panel data will be used in the regression estimations as mentioned in Love (2011). Panel data has the ability to study the dynamics of adjustment in the firm value because cross-sectional distribution that looks relatively stable conceals a lot of changes (Jara, López, & López-de-Foronda, 2008).

b. Sample and variables definition

The dataset for the empirical analysis was obtained from different sources. The audited financial statements and stock quotations at the end of each fiscal year were gathered from the *Thomson Reuters* database. Like in other empirical works on corporate governance, all financial firms are excluded from the analysis because the very nature of their business and its regulatory system might bias the findings; as well as firms with negative equity which are firms that are technically in bankruptcy, and those firm with lack of information for the empirical analysis (Booth, Aivazian, Demirgüç-Kunt, & Maksimovic, 2001; Vallelado & Saona, 2011). The macroeconomic information at country level was obtained from the updated data based on the work of Beck et al. (2000) publicly available at the World Bank web page, which provides information about financial development by country and year.⁶ Worldwide governance indicators concerning the legal and regulatory systems by country was obtained from the updated

⁵ However, this is not considered a problem because $\Delta\varepsilon_{it} = \varepsilon_{it} - \varepsilon_{it-1}$ might be correlated with $\Delta\varepsilon_{it-1} = \varepsilon_{it-1} - \varepsilon_{it-2}$ given that both share the common term ε_{it-1} .

⁶ The latest update took place in November 2013. Information can be downloaded from the permanent URL <http://go.worldbank.org/X23UD9QUX0>

work of Kaufmann et al. (2011) whose data set is also publicly available.⁷ The sample is composed by 558 firms from Argentina, Brazil, Chile, Colombia, Mexico, and Peru. The empirical analysis ranges the period 1997-2013 (although one observation comes from year 2014. See Table 2, Panels A and B) which allows us to have an average of 7.25 continuous observations per firm.

Once the sample is constructed, the next step is the variable definition. In this regard, the variables considered in the empirical analysis are directly related with the literature review. Details on the construction of dependent and independent variables (including the control variables) might be briefly depicted as follows and more details can be found in the Appendix:

Firm value: is calculated as the market to book ratio (FV).

Corporate ownership structure: which may be measured by the levels of ownership concentration and insider ownership (Azofra, Saona, & Vallelado, 2004; Espinosa, 2009; Saona & Vallelado, 2005). For the ownership concentration (Own) we will consider the ownership of the controlling shareholder. For the insider ownership (InsOwn) we will use the ownership closely held.

Capital structure decisions: will be measured by the leverage at book value (Lev) (Hovakimian & Li, 2011).

Dividend policy: following Mitton (2004) and Adjaoud and Ben-Amar (2010) the payout ratio is measured primarily as the dividends per share over the earnings per share (Div).

Firm size: Lang and Stulz (1994) suggest that larger and more diversified firms show lower firm value as a consequence of a lack of growth opportunities. This is also verified by McConnell & Servaes (1990), Lins (2003), de Miguel et al. (2004), Klapper and Love (2004), and Saona (2014).

Profitability: More profitable firms, and consequently with more benefits to distribute among the shareholders in the form of dividends, show higher firm value. Therefore, the return on assets (ROA) which measures the efficiency of the assets is positively related with the value of the firm (Haugen & Baker, 1996; Yang, Lee, Gu, & Lee, 2010).

Firm risk: This corresponds to a control variable (Z). Following Love (2011)'s suggestion, it is important that regressions of firm value on corporate governance control for risk to make sure governance is not spuriously picking up the omitted risk effect. After risk is controlled for, in an efficient market there should not be any relationship between governance and firm value –or returns–, because all differences in governance systems will be appropriately priced by informed investors. Consequently, the reason of including this variable in the regression estimates relies on market inefficiency arguments. The insolvency risk was measured through the alternative Altman Z-Score which was specifically derived for developing countries (Altman, 2005).

Bank Concentration: is the market share of the three largest banks per country.

⁷ The latest update took place in September 2014. Information can be download from www.govindicators.org

Legal enforcement and regulatory system: Using the data base provided in Kaufmann et al. (2011), for the legal system we include the following variables, resulting in a total of six dimensions of governance: (i) Voice and Accountability (VA); (ii) Political Stability and Absence of Violence/Terrorism (PS); (iii) the Government Effectiveness (GE); (iv) Regulatory Quality (RQ); (v) Rule of Law (RL); and (vi) the Control of Corruption (CC). Although these original six indicators range from approximately -2.5 (weak) to 2.5 (strong) governance performance, in our sample the values are not that extreme.

Financial development: Six measures of financial development are used throughout the paper. The first three of them are associated to the development of the banking system such as the i) the Deposit Money Bank Assets to GDP (DBAGDP); ii) the Private Credit by Deposit Money Banks to GDP (PCBGDP); and iii) Bank Credit to Bank Deposits (BCBD). The last three variables measure the development of the capital markets: i) Stock Market Capitalization to GDP (SMKGDP); ii) Stock Market Total Value Traded to GDP (SMKVTGDP); and iii) the Stock Market Turnover Ratio (SMKTO). Data for all these measures were obtained from Beck et al. (2000). These measures are considered to explore the different channels by which financial development affects the firm value, especially the role of information and market structure (banking system versus capital markets), and to check the robustness of the results to the use of measures that capture different dimensions of financial development.

Since the literature has shown that the legal enforcement of the law (and regulatory systems) are associated with deeper and more developed financial markets (Claessens & Yurtoglu, 2013), we will have to interpret cautiously our results when both kind of variables are introduced in the econometric models in order to avoid autocorrelation problems.

Dummy variables: International Financial Reporting System (IFRS), Industry-level, country-level and year-level variables are included in the models as control variables too.

c. Model

The estimation model is in line with our theoretical framework and hypotheses development and according to the following dynamic panel data model:

$$\begin{aligned}
 FV_{it} = & \beta_0 FV_{it-1} + \beta_1 Own_{it} + \beta_2 Own_{it}^2 + \beta_3 Lev_{it} + \beta_4 Lev_{it}^2 + \beta_5 Div_{it} \\
 & + \beta_6 LegSys_{it} + \beta_7 FinDev_{it} + \beta_8 Z_{it} + \beta_9 Size_{it} + \beta_{10} ROA_{it} \\
 & + \beta_{11} IFRS_{it} + \beta_{12} TimeDummies_t + \beta_{13} CountryDummies \\
 & + \beta_{14} IndDummies + \epsilon_t + \mu_t + \varepsilon_{it}
 \end{aligned}$$

Where FV_{it} represents the firm value for the i firm in the t period; FV_{it-1} is the lagged value of the firm⁸, Own is the ownership structure, Lev is the proxy for the capital structure, Div is the dividend policy. $LegSys$ and $FinDev$ are country-level variables which represent the different alternative measures of the development of the legal and regulatory systems and financial development, respectively. Z , $Size$ and ROA , are

⁸ Since it is expected that the current value of the firm value be determined by its historical performance, we decided to incorporate this dynamic aspect in the model by entering the on-period lagged dependent variable into the right hand side of the model.

control variables at firm-level which correspond to the default risk level, the firm size, and the profitability, respectively.

4) Results

a. Descriptive statistics

Table 3 displays the most important statistics for the variables used in the empirical analysis. It can be observed that the market value of a representative firm is about 5.42 times greater than its book value (BV). This simple statistics shows how overpriced the firm value is in developing countries. Among the firm-level governance devices, we observe that the corporate ownership structure is highly concentrated in Latin America as mentioned in previous literature (Paredes & Flor, 1993; Sáenz González & García-Meca, 2014). Particularly, the outstanding shares in hands of both executives and the controlling shareholder (InsOwn) represent about 55.60% of total common shares. It has been widely justified the usage of cross ownership and pyramidal structures in emerging economies. As it was mentioned previously, the high ownership concentration in emerging markets is the natural response to the lack of efficient corporate governance mechanisms to ensure the protection of the investors' rights. The shares in hands of the controlling shareholder (Own) are about 24.5% for a typical firm.

An average firm has a debt level (Lev) of 54.40% of total assets and a pay-out ratio (Div) of almost 42% of earnings. In terms of the firms profitability we can observe an average rate of return on assets of about 6.40% for our sample. Since the average indicator for the insolvency risk (Z) is higher than 2.6, we can say that a typical firm is operating in the safe zone with low bankruptcy risk.

All the other variables are basically indicators which measure the country-level determinants of the firm value. The country-level variables are classified basically in two big groups (see Table 3, Panels A and B). The first one is related with the development of the legal enforcement and regulatory system; and the second group includes variables which measure the financial development of capital markets.

The legal enforcement and regulatory system variables are basically six corporate governance indicators by country recorded in Kaufmann et al. (2011). In addition to that we have included a dummy variable which measures the adoption of the International Financial Reporting System (IFRS). Based on this variable, we can observe that about 38.20% of the observations in our sample have adopted the IFRS standards.⁹ The worldwide governance indicators are: (i) Voice and Accountability (VA) which is the process by which governments are selected, monitored, and replaced; (ii) Political Stability and Absence of Violence/Terrorism (PS) which is measures the perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism; (iii) the Government Effectiveness (GE) corresponds to the quality of public and civil services, and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies; (iv) Regulatory Quality (RQ) which

⁹ This is a consequence of the gradual adoption of the IFRS of the firms in our sample during the period of analysis. For instance, Brazil and Chile adopted the international accounting standards in 2010, Argentina in 2011, Mexico and Peru in 2012 and Colombia in 2015 (outside of our period of analysis).

measures the perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development; (v) Rule of Law (RL) which reflects the confidence of the agents in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence; and finally (vi) the Control of Corruption (CC) which measures the perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. Despite the original values for each one of these six indicators ranges from approximately -2.5 (weak) to 2.5 (strong) governance performance (Kaufmann, et al., 2011); in our sample such values are not that extreme.

Concerning the financial development variables as determinants of the firm value, we have included the bank concentration which shows that the three largest banks have an average 57.79% of the market share. In addition to this particular variable, we have used other six different indicators which measure the relative development of the financial markets. These indicators in turn might be broken down in two subgroups: i) development of the banking system and ii) development of the capital market as suppliers of funds. The development of the banking system includes the Deposit money bank assets to GDP (DMBAGDP); Private credit by deposit money banks and other financial institutions to GDP (PCOFIGDP); and Bank credit to bank deposits (BCBD); whilst the development of the capital market is measured by the Stock market capitalization to GDP (SMKGDP); Stock market total value traded to GDP (SMKVTGDP); and the Stock market turnover ratio (SMKTO).

The descriptive statistics shows that the deposit money bank assets represent about 56.10% of the GDP for the whole sample; whilst the stock market capitalization corresponds to the 48.52% of the GDP. This simple description identifies how relevant is the banking sector as supplier of funds of firms in Latin America. The civil-law regime which characterizes the legal systems for the Latin American countries, has favored funds privately supplied through bank debt. Consequently, it is expected a higher relative size of the banking system than the capital markets in these kinds of emerging economies.

Table 4 shows the correlation matrix where we do not observe any relatively high correlation among the independent variables. This minimizes the likelihood of observing autocorrelation problems.

b. Multivariate analysis

Table 5 displays the regressions between the independent variables and the firm value (FV). In all the regressions we observe that the independent variables are jointly statistically significant according to the Wald test. There is not second-order autocorrelation among the variables despite of in some regressions we do observe first-order autocorrelation. This fact does not invalidate our results. Since the very nature of the panel data it is expected certain level of first-order autocorrelation at the standard 5% confidence level according to Arellano and Bond (1991). Regarding to the moment conditions, both the Sargan and Hansen overidentification tests did not reject the overidentifying restrictions, meaning that the set of instruments are orthogonal to the

estimated residuals. Thus, the results reported in Table 5 are robust according to the standard diagnostic tests for the panel data.

i. Firm-level determinants

First of all we observe that the one-period lagged dependent variable is always statistically significant and, as expected, the dynamic effect of the firm value in the past impacts positively the firm value in the current period (Jara, et al., 2008).

Table 5 helps us to assess the impact of the corporate ownership structure (Own) as governance system on the firm value. The formulated hypothesis suggested a non-linear relationship between the corporate ownership structure and the firm value. Such expected result is supported by the interaction of both the monitoring and the expropriation hypotheses. Our findings support the non-linear relationship between Own and FV. In fact we can observe that as the concentration of the corporate ownership increases, the firm value increases also as a consequence of less principal-agent conflict of interests. Therefore, it seems to be that the controlling shareholders fulfill efficiently his or her role as monitor, which aligns the interest between shareholders and executives. Nevertheless, when the concentration of the ownership becomes excessive, the firm value is eroded as a result of the expropriation of the wealth of minority shareholders by the controlling one. In all the regression in Table 5 we observe that the sign for the Own^2 (the squared computation of Own) variable is negative and statistically significant. This means that the function takes a quadratic form where the firm value is optimized at a certain level (critical value) of the concentration of the corporate ownership. This critical value can be easily estimate by the optimization of each regression as a function of the Own variable. For instance, in regression (1) of Table 5 we observe that the critical value is at 36.00% of the corporate ownership.¹⁰ This means that the monitoring hypothesis is predominant and value created as long as the concentration of the ownership is not longer that 36.00%. Nevertheless, when the concentration goes beyond that level, the expropriation problem appears pressing down the firm value. The average critical value among all the regressions included in Table 5 is about 38.32%. Consequently, this approximately represents the threshold at which the firm value is maximized for a typical Latin American firm. In order to test this inverse U-shaped relationship between Own and FV the appropriate Lind-Mehlum test (Lind & Mehlum, 2010) is used. According with the results provided at the bottom of the table, the null hypothesis of a monotone or U-shape is rejected for all the regressions. Therefore, it is accepted the hypothesis H1 since it was found that there is a statistically inverse U-shaped relationship exists between the corporate ownership concentration and the firm value, supported by the interaction between the monitoring and the expropriation hypothesis.

We cannot accept the hypothesis H2 according to the second and third regressions in Table 5. In fact, in these two regressions we observe the opposite effect: the higher the degree of financial leverage (Lev) the lower the firm value (FV). It seems to be that in

¹⁰ The computation of the critical value in the first regression of Table 3 is done by calculating the first derivative of this regression with respect to the Own variable, and then makes it equal to zero. After that we have to solve for Own which represents the point at which the firm value is maximized. Specifically talking, this solution takes the form: $\partial \text{FV} / \partial \text{Own} = 4.501 + 2(-6.254 \times \text{Own}) = 0$. Consequently, when $\text{Own} = 36.00\%$ the firm value is maximized. Idem calculations are than for all the other regressions which include Own^2 .

immature financial markets firms are excessively leveraged, and consequently the bankruptcy risk raised by more debt destroys certain value for the firm. This preliminary finding might be reinforced when the financial leverage is deeper analyzed. Regressions (5) through (10) provide the information for the statistical contrast of hypothesis H3. There we can see that firm value increases and then decreases as the debt level raises. The trade-off approach provides a lucid explanation for a result like this. In the particular case of the regression (5) it is observed that since the interests paid on debt are tax deductible, the higher the level of debt there is a positive impact on the firm value. Nevertheless it seems to be that when the leverage is about 58.00% then the firm value is pressed down as a consequence of the higher default risk. The computation of this critical value is similar to the one described in the foot note 11 for the corporate ownership structure. The range of such critical value of the degree of financial leverage goes from 46.60% to 60.07% with an average value of 54.40% calculated among the last six regressions in Table 5. This finding deserves to be highlighted because such average critical value for the leverage position is almost the same as the average level of debt of 54.40% described in Table 3, Panel A. Consequently, we might state that firms in Latin America are operating with a level of debt fairly close to the one which maximizes the firm value. Once again we used the Lind-Mehlum test to check out whether such non-monotone inverse U-shaped relationship between Lev and FV is statistically significant. As it can be seen at the end of the table, it is rejected the null hypothesis monotone or U-shaped relationship in all the regressions including Lev.² Consequently, we accept our hypothesis H3 which supports an inverse non-monotone U-shaped association between Lev and FV.

Table 5 shows the dividend policy relationship with the firm value (Div). In the last three regressions we can see that there is a negative and statistically significant relationship between the dividend payout and the value of the firm. This finding does not support our hypothesis H4. In fact, this result is the opposite to those evidenced in previous empirical works for local contexts such as in Chile (Saona, 2014), where we show that the disbursement of cash in dividends does not work efficiently as a corporate governance system in Latin America. The dividends do not resolve the discretionary managerial behavior by shorting the cash flows which otherwise might be opportunistically used by executives. The Easterbrook (1984)'s argument seem not to work for the case of Latin American companies neither. When companies need external funds from the market to finance the cash dividends, these participants in the financial markets do not take a superior role by monitoring the performance of the firm. Although La Porta et al. (2000) suggested that firms in countries with strong protection of the investors' rights pay higher dividend than in countries with weak investors' rights, our results seem to indicate the opposite relations. For instance, in an study particularly for emerging markets, Mitton (2004) argues that even when shareholders are well protected they may not prefer higher dividend payouts if they believe the firm has good investment opportunities available for excess cash. That is, it appears that, when shareholders perceive that their rights are well protected, they are more willing to let firms with good growth opportunities retain cash, being confident that they will share in the payoff from good projects later on. In contrast, if shareholders know that investor protection is poor such as in the case of Latin American firms, they may be more haphazard in their desire for dividends, trying to extract whatever value they can – regardless of the firm's growth opportunities– before being expropriated. Consequently, shareholders will push managers to pay cash dividends soon and let profitable investment project unfunded. As direct outcome of a strategy like this, the firm value

will be spoilt as shown in the negative and statistically significant coefficients for variable Div in Table 5.

At country-level variables in Table 5 only two measures are included so far (BankConc and IFRS). Further analysis on country-level variables is depicted in Table 6. The IFRS variable is an indirect measure of the efficiency of the legal and regulatory system. Table 5 suggests that the value of the firm increased for those firms which adopted the International Financial Reporting System. In fact, the firm value is between 18.40% and 24.30% higher for those firms which changed from local accounting standards to the international reporting systems (see regressions 8 and 9 in Table 5). The BankConc variable is associated with the development of the financial system. This variable measures the average market share by the three largest banks per country. A higher BankConc variable means a relatively less developed and efficient financial system as a consequence of the monopoly power exercised by financial institutions in the banking system. In Table 5 we see that more concentrated banking systems impact positively the firm value. In other words, in emerging markets such as those of Latin America with immature financial system, firms take advantage of higher financial opacity to increase the market value of the firm. More details about the development of the financial system and its impact on the market value of the firm are provided in Table 6.

Among the control variables we included the firm size (Size), the profitability (ROA) and the insolvency risk (Z). The main results displayed in Table 5 show that the physical dimension of the firm (Size) impacts negatively its market value. It seems to be that larger and consequently more complex firms are more difficult to be monitored. The making decision process in large firms is perhaps more bureaucratic and time consuming. Larger firms are also more matured, diversified, and sometimes are operating in non-profitable industries which impact negatively the firm value. On the contrary, smaller firms are more dynamic and able to adjust quickly their financial decisions to the market shocks. Moreover, smaller firms have more growth opportunities than large firms, which in turn impacts positively on the value of the firm. In addition to that it is worthy to mention that more profitable firms (ROA) show relatively higher firm value than less profitable firms. The economic impact of the coefficient for ROA variable is remarkably high –it is in between 6.525 and 7.177 in the last three regressions in Table 5– which indicates that the investment decisions and their capacity to generate income are quite important determinant of the firm value. The last of the control variables is the insolvency risk (Z) measured through the modified version of the Altman Z-Score for emerging countries (Altman, 2005). According to the construction of this variable the insolvency risk increases as the variable Z decreases. Therefore, as it can be seen in Table 5 the positive sign of Z variable must be interpreted as a negative impact of the default risk on the value of the firm.

ii. Country-level corporate governance variables

Table 6 offers further details about the impact of the country-level variables of corporate governance on the firm value. The first six columns include variables which describe the development of the financial system (e.g. banking system and capital markets) and the last six columns include governance indicators about the legal and regulatory systems.

As it can be observed in Table 6 the impact of the adoption of the IFRS to disclose financial reports is still positively associated with abnormal returns. The international accounting standards as a governance mechanism are aimed to standardize the financial information and improve the quality of the accounting reports by reducing the opacity of the accounting numbers (Soderstrom & Sun, 2007).

The variables which measure the deepness of the financial system as governance tool are shared into two groups, those that measure the development of the banking system (DBAGDP, PCBGDP, and BCBBD) and those that measure the development of the capital markets –common equity basically– (SMKGGDP, SMKVTGGDP, and SMKTO). The higher the number of these variables, the more developed the financial system in general. The regression in Table 6 show that all these variables consistently impact negatively on the firms' abnormal returns at the standard level of statistical significance. Contrary to what was hypothesized, the results reject the fact that more developed financial systems impact positively the firm value in emerging markets. These findings are in line with those reported by Saona and Muro (2015), suggesting that more developed banking systems where banks can offer more complex and sophisticated financial instruments and services, on the one hand, and where bank can exercise efficiently a monitoring role on the performance of the firm, on the other hand, seem to reduce the firms' abnormal returns. This might be explained saying that in emerging markets such as those in Latin America, firms have taken advantage of such immature stage of development of their financial systems characterized by the opacity, large asymmetries of information, and lack of regulation, in order to raise abnormal returns, which are not perceived as such by the participants in these markets. Consequently, when the financial markets achieve a higher stage of development, such abnormal returns are minimized. The variables concerning the development of the capital markets include the stock market capitalization (SMKGGDP), the stock market total value traded (SMKVTGGDP), and the stock market turnover ratio (SMKTO). Similarly to the banking system variables, those that measure the development of the equity markets impact negatively the firm value. Consequently, as the stock markets become more developed, dynamic, and transparent, the participants of these markets might scrutinize more efficiently the firms. In such process there are less chances to get abnormal returns. When markets are fairly developed, analysts are able to grab more information about the company and spread it out among the different stakeholders, new financial tools appear which demand for higher disclosure of information, the market for takeovers is more dynamic and consequently the room for making abnormal profits is minimized, supporting the negative relationship between the financial development variables and the market value.

Concerning the legal system and the regulatory environment in the Latin American region (see the last six columns of Table 6), we entered the variables Voice and Accountability (VA), Political Stability and Absence of Violence/Terrorism (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and the Control of Corruption (CC). Since all of these variables are highly correlated we introduced them one by one in the regressions. All these variables show a positive and statistically significant coefficient at the standard confidence level except RQ variable (although still have a positive sign). This finding indicates that as the legal and regulatory systems improve the firm value of Latin American corporations increase. Legal bodies mandating disclosure and private enforcement through liability rules and granting the control of issues such as corruption and political instability benefit significantly the value of the firm. This finding allows accepting our H5 hypothesis

which suggests a positive relationship between the improvements of the legal and regulatory systems and FV.

iii. Principal Component Factoring Analysis

Since we account with a number of variables used as measures for the external governance indicators, and due all these variables are highly correlated (see Table 4) we cannot include them altogether in the regression and we opted by introducing these variables individually as displayed in Table 6. In order to address this drawback in modeling the value of the firm, we decided to apply the principal component factoring technique in order to enter all this variables in the same regression to take advantage of their informative content. The major benefits of this technique are that the factor(s) created is not correlated, on the one hand, and the factor(s) records a large extent of the variability of the individuals variables used in the estimation of the factor(s), on the other hand. Table 7 displays the number of factors generated for the variables used to measure the financial development and the variables used for the legal and regulatory system. In its Panel A we can observe that there is only one factor which measures the country financial development whose Eigen value is higher than one as the standard discrimination value. This factors record about 74.20% of the variability of the six alternative variables used to measure the financial development by country (DBAGDP, PCBGDOP, BCB, SMKGDP, SMKVTGDP, and SMKTO). Panel B however shows that there are two factors important enough to record more than 78.70% of the variability of the variables used to measure the legal and regulatory systems (VA, PS, GE, RQ, RL, and CC). All these factors are included in the regression analysis as shown in Table 8.

As we saw previously, Table 8 provides an even stronger evidence of the negative impact of the variables related to the financial development –now included in the composite factor *FinDevFactor1*– on the firm value. Concerning the variables associated to legal and regulatory systems –now included in the factors *LegalEnvFactor1* and *LegalEnvFactor2*– they do still impact positively on the market value of the firm. All the other variables are in line with our previous empirical findings described above. The one-period lagged firm value variable FV_{t-1} has a relatively high and positive impact on the firm value. This finding suggests that there is a relatively high persistence in the firm value.

iv. Comparative Analysis by Institutional System

The last part of the empirical analysis offers a comparison by institutional context. In this case, we decided to split the sample in two big groups depending on the relative efficiency of their legal and regulatory systems. In order to do so, we computed the average among VA, PS, GE, RQ, RL, and CC by country as seen in the variable *LegalSys* in Panel B of Table 3. Only Chile and Brazil had a positive value and the other countries had a negative average. This means that, for our period of analysis and sample, Chile and Brazil had relatively better institutional environment than Argentina, Colombia, Mexico, and Peru. Therefore, we re-estimated the regressions taking into consideration these two groups of countries. The results are displayed in Table 9. In this table we observe that under both institutional contexts the majority shareholder in his or

her controlling role does an efficient work as long as this controlling shareholder has no more than roughly 42.00% of the outstanding shares. Beyond this level of corporate ownership concentration the expropriation of minority shareholders appears.

In terms the ownership in hands of the controlling shareholder and managers (PcShCIHld), the non-linear effect lost in countries with weaker legal systems. In fact, the relationship turns out to be negative, highlighting the expropriation and entrenchment hypotheses.

Concerning the leverage (Lev), it seems to be that the trade-off theory provides a sound background to support the way firms in Latin America make their capital structure decisions. In other words, we can say that in general firms take advantage of the tax deductibility of interests paid on debt by increasing the leverage up to the point where the benefits of debt are greater than the marginal bankruptcy costs. Nevertheless, it seems to be that in Chile and in Brazil the insolvency risk takes place at lower levels of debt (between 50.9% and 57.6% of total assets) than in the other countries (between 60.6% and 64.5% of total assets) according to the critical values estimated for the Lev variable.

Additionally, we observe that the dividend policy generates value for Chilean and Brazilian firms; but it destroys value in the other Latin American countries included in the sample. Finally, the different factors used to measure the financial development and the legal and regulatory systems behave in the same way as analyzed above.

5) Conclusions

The goal of this paper was to analyze how the internal and external corporate governance mechanisms impact the market value of Latin American firms. At the firm-level corporate governance mechanisms, our results confirm that ownership structure plays a very important role in monitoring firms. This fact impacts positively on the firm value, which confirms the monitoring hypothesis up to certain level of concentration –or critical value–. Beyond that level of concentration the firm value is destroyed, supporting the expropriation hypothesis. Concerning the financial leverage as another corporate governance tool, we found that the firm value experiences a non-linear relationship with the debt level. Additionally, the dividend policy seems to show a relationship differently than the one suggested by the theoretical arguments. It seems to be that the investors have much better perception about those firms which pay out dividends than those which do not pay (or pay less) dividends. This conclusion suggests that as a consequence of the lack of protection of the investors' rights in Latin America, the individual investor is looking for short payback periods in order to recover soon the investment in the company.

Concerning the external corporate governance mechanisms there is a dissimilar influence of the financial development of the country vis-à-vis the enhancements of the legal and regulatory systems. On the one hand, we conclude that, contrary to what was expected, the development of the financial system impacts negatively on the firm value. In immature financial markets such as those in Latin America, firms take advantage of both the asymmetries of information and the multiple market frictions to generate abnormal returns. Consequently, when the financial markets become more efficient, the market competition increases by pressing down the abnormal returns and therefore the

market value of the firm. On the other hand, concerning the legal and regulatory systems, we conclude that the enforcement of the law is a key driver of the firm value.

This work has both corporate governance and policy level implications. At the corporate governance level, we provide evidence that a good regulatory system which protects efficiently the rights of the shareholders is associated with a premium in the market value of the firm. This fact generates higher market confidence which allows firms to undertake profitable investment options. Despite of this positive view of the efficiency of the regulatory systems in Latin America, we observe also that expropriation of minority shareholders by the controlling shareholders is still a proven fact. Consequently, it is suggested that policy makers undertake measures to improve even further the rights of the minority shareholders. Moral hazard problems such as the expropriation of minority shareholders need to be addressed in Latin America. Finally, and in the same line, we observe that there is a demand for improvements in the financial systems. Despite of the advances in the development of capital markets in Latin America over the period of analysis, there is still a lack of competition which allows firms to get abnormal profits –which are basically present in imperfect markets–. Therefore, measures to develop even more the financial systems are needed to alleviate of this market imperfections.

Table 1. Summary of Empirical Literature on Firm Value for Emerging Markets

Authors	Year	Journal	Topic	Period	Firms (Observations)
Booth et al.	2001	Journal of Finance	Capital structure in developing countries	1985 - 1991	Brazil: 49 México: 99
Lins	2003	Journal of Financial and Quantitative Analysis	Firm value of emerging markets	1995 - 1997	Argentina: 9 Brazil: 59 Chile: 30 Peru: 10
Klapper and Love	2004	Journal of Corporate Finance	Firm performance in emerging markets	1999	Brazil: 24 Chile: 13
Garay and González	2008	Corporate Governance: An international review	Firm value and corporate governance	2004	Venezuela: 46
Morey et al.	2009	Journal of Banking & Finance	Firm value and corporate governance	2001 - 2006	Argentina: 5 Brazil: 45 Chile: 11 Mexico: 23
Lopez and Crisostomo	2010	Emerging Market Finance & Trade	Determinants of the firm value	1995 - 2004	Brazil: 213
Cespedes et al.	2010	Journal of Business Research	Capital Structure – Debt determinant with focus on corporate ownership structure	1996 - 2005	Full sample: 7,167 (2,860) Argentina: 716 (282) Brazil: 2,822 (1,242) Chile: 1,363 (524) Colombia: 174 (24) Mexico: 1319 (622) Peru: 561 (83) Venezuela: 212 (83)
Perreira and Ferreira	2011	Journal of Multinational Financial Management	Capital structure around the world	1996 - 2001	Brazil: 25 (55) Chile: 54 (227) And other 29 countries
Espinoza et al.	2012	Investigación Económica	Capital structure in Latin America	1998 - 2007	Argentina: 23 Chile: 50 México: 41 Peru: 19
Kirch and Soares	2012	Journal of Corporate Finance	Capital Structure - Debt maturity	1996 – 2007	Full sample: 359 (2,744) Argentina: 54 (439) Brazil: 222 (1,691) Chile: 40 (336) Peru: 37 (224) Venezuela: 6 (44)
Saona	2014	Review of Managerial Science	Determinants of the firm value	2002 - 2010	Chile: 184 (1,317)

Table 2. Composition of the Panel Data

Panel A: By Country			
Country	Observations	Firms	Avg. Obs. per Country
Argentina	231	32	7.2
Brazil	1586	216	7.3
Chile	737	95	7.8
Colombia	186	28	6.6
Mexico	677	93	7.3
Peru	631	94	6.7
Total	4,048	558	7.25

Panel B: By Year	
Year	Observations
1997	84
1998	88
1999	101
2000	148
2001	158
2002	154
2003	161
2004	149
2005	173
2006	230
2007	350
2008	378
2009	333
2010	396
2011	412
2012	410
2013	322
2014	1
Total	4,048

Table 3. Descriptive Statistics

Panel A and Panel B show the data used in the empirical analysis. For each variable of the Panel A, it shown the number of observations (Obs); mean (Mean); standard deviation (Std Dev); minimum (Min) and maximum (Max) values of the variables, breaking down the variables in firm-level variables and in country-level variables (the legal and regulatory systems variables and the financial development variables). Panel B shows the same information by country.

Panel A: Descriptive Statistics by Variables						
Variable	Description	Obs	Mean	Std. Dev.	Min	Max
FV	Firm value	4048	5.423	6.345	0.002	33.967
Own	Corporate ownership structure	4048	0.245	0.257	0.000	1.000
PcShCIHId	Corporate ownership structure	2189	0.556	0.275	0.000	1.000
Lev	Leverage	4048	0.544	0.225	0.007	0.947
DIV	Dividend policy	4048	0.417	0.609	0.000	3.974
Size	Firm size	4048	6.617	1.967	0.211	13.223
ROA	Profitability	4048	0.064	0.103	-0.438	0.623
Z	Insolvency risk	4048	10.652	3.6091	0.388	154.917
IFRS	Local vs international accounting standards	4048	0.382	0.486	0.000	1.000
VA	Legal enforcement and regulatory system	4047	0.302	0.215	-0.575	1.244
PS	Legal enforcement and regulatory system	4047	-0.310	0.389	-1.842	0.851
GE	Legal enforcement and regulatory system	4047	-0.061	0.207	-0.600	1.261
RQ	Legal enforcement and regulatory system	4047	0.166	0.309	-0.989	1.540
RL	Legal enforcement and regulatory system	4047	-0.370	0.267	-0.978	1.367
CC	Legal enforcement and regulatory system	4047	-0.145	0.208	-0.523	1.562
BankConc	Bank concentration	4042	57.791	15.954	0.000	86.818
DMBAGDP	Financial development	4047	56.096	26.263	0.000	91.928
PCOFIGDP	Financial development	4047	36.022	17.233	0.000	89.128
BCBD	Financial development	4047	84.279	19.652	44.516	201.292
SMKGDP	Financial development	4047	48.523	18.808	0.000	132.320
SMKVTGDP	Financial development	4047	19.979	15.692	0.000	40.945
SMKTO	Financial development	4047	40.578	25.082	0.000	87.786

Panel B: Financial System and Legal and Regulatory Systems Variables by Country						
Variable	Argentina	Brazil	Chile	Colombia	Mexico	Peru
DBAGDP	26.697	77.223	29.419	37.525	30.706	24.253
PCBGDP	15.091	47.555	38.883	35.909	19.070	22.402
BCBD	69.214	88.138	148.710	154.929	69.904	85.431
SMKGDP	29.403	55.620	56.893	42.449	27.206	52.325
SMKVTGDP	2.691	31.054	9.888	4.782	7.574	3.432
SMKTO	11.048	58.817	8.097	10.791	28.691	7.163
VA	0.288	0.430	1.080	-0.252	0.161	0.012
PS	-0.111	-0.106	0.574	-1.566	-0.470	-0.892
GE	-0.082	-0.084	1.216	-0.086	0.219	-0.266
RQ	-0.548	0.125	1.466	0.242	0.351	0.399
RL	-0.582	-0.234	1.293	-0.527	-0.499	-0.656
CC	-0.418	-0.037	1.446	-0.361	-0.290	-0.294
LegalSys	-0.242	0.016	1.179	-0.425	-0.088	-0.283
Obs	231	1,586	737	186	677	631

Table 4. Correlation Matrix

The table shows the correlation coefficients among the variables included in the analysis

Variables	1	2	3	4	5	6	7	8	9	10	11	12
1 FV	1.000											
2 Own	-0.006	1.000										
3 PcShCIHid	0.050	0.338	1.000									
4 Lev	-0.099	0.017	-0.008	1.000								
5 Div	-0.068	0.018	0.020	-0.105	1.000							
6 Size	-0.135	-0.006	-0.130	0.372	0.074	1.000						
7 ROA	0.128	0.030	0.070	-0.252	0.195	-0.046	1.000					
8 Z	0.619	-0.017	0.042	-0.309	-0.036	-0.206	0.131	1.000				
9 IFRS	-0.083	0.168	-0.171	-0.035	0.077	0.032	0.115	-0.015	1.000			
10 BankConc	0.019	0.156	-0.049	0.002	0.055	-0.061	0.134	0.016	0.555	1.000		
11 DBAGDP	-0.353	-0.088	-0.219	0.051	0.080	0.276	0.000	-0.197	0.175	-0.041	1.000	
12 PCBGDOP	-0.327	-0.005	-0.230	0.035	0.096	0.251	0.026	-0.189	0.411	0.178	0.926	1.000
13 BCBd	-0.224	0.105	-0.199	-0.016	0.106	0.139	0.049	-0.139	0.643	0.359	0.510	0.770
14 SMKGDp	-0.288	0.083	-0.088	-0.002	0.075	0.130	0.133	-0.135	0.385	0.374	0.598	0.663
15 SMKVTGDp	-0.296	-0.026	-0.192	0.043	0.066	0.257	0.002	-0.166	0.240	0.085	0.936	0.948
16 SMKTO	-0.261	-0.088	-0.187	0.037	0.059	0.283	-0.051	-0.153	0.088	-0.084	0.930	0.889
17 VA	-0.268	-0.065	-0.094	0.037	0.025	0.165	0.036	-0.124	-0.033	-0.199	0.740	0.616
18 PS	-0.256	-0.137	-0.092	0.030	0.036	0.163	-0.048	-0.129	-0.160	-0.459	0.534	0.381
19 GE	0.256	-0.111	-0.009	0.018	-0.097	0.001	-0.171	0.072	-0.234	-0.361	-0.031	-0.072
20 RQ	0.064	-0.038	-0.032	-0.038	0.049	-0.001	0.012	-0.015	0.171	0.380	-0.003	0.102
21 RL	-0.275	-0.079	-0.199	0.006	0.094	0.204	0.011	-0.163	0.316	0.004	0.781	0.825
22 CC	-0.313	-0.136	-0.132	-0.005	0.097	0.140	0.040	-0.178	0.081	-0.118	0.670	0.616
	12	13	14	15	16	17	18	19	20	21		
12 PCBGDOP	1.000											
13 BCBd	0.770	1.000										
14 SMKGDp	0.663	0.432	1.000									
15 SMKVTGDp	0.948	0.607	0.656	1.000								
16 SMKTO	0.889	0.513	0.493	0.954	1.000							
17 VA	0.616	0.203	0.441	0.713	0.681	1.000						
18 PS	0.381	0.087	-0.105	0.437	0.526	0.667	1.000					
19 GE	-0.072	-0.045	-0.332	-0.076	0.037	0.073	0.278	1.000				
20 RQ	0.102	0.249	0.148	-0.027	0.014	-0.268	-0.292	0.351	1.000			
21 RL	0.825	0.710	0.376	0.745	0.732	0.666	0.589	0.291	0.223	1.000		
22 CC	0.616	0.427	0.335	0.564	0.590	0.625	0.497	0.284	0.347	0.810		

Table 5. Regression Analysis. Dependent Variable is FV.

The sample includes firms from Argentina, Brazil, Chile, Colombia, Mexico, and Peru. The period is 1997-2014. The estimated regression model takes the form:

$$FV_{it} = \beta_0 FV_{it-1} + \beta_1 Own_{it} + \beta_2 Own_{it}^2 + \beta_3 Lev_{it} + \beta_4 Lev_{it}^2 + \beta_5 Div_{it} + \beta_6 Size_{it} + \beta_7 Roa_{it} + \beta_8 Risk_{it} + \beta_9 IFRS_{it} + \beta_{10} BankConc_{it} + \beta_{11} TimeDummies_t + \beta_{12} CountryDummies + \beta_{13} IndDummies + \epsilon_t + \mu_t + \epsilon_{it}$$

The table shows the regression results for the GMM System Estimator. A detailed definition of variables is provided in the Appendix. Critical Value is the threshold in the ownership concentration and leverage at which the firm value is maximized. The Wald test is a Chi-square test of the joint significance of all of the variables considered in the analysis. AR1 and AR2 correspond to the first- and second-order serial correlation tests using residuals in first differences, asymptotically distributed as N(0,1) under the null of no serial correlation. The Sargan and Hansen tests of overidentifying restrictions are asymptotically distributed as Chi-square under the null of no relation between the instruments and the error term. Lind-Mehlum's test is used to verify the inverted U-shaped relationship in the case of both the corporate ownership structure (Own) and the leverage (Lev). Standard deviations are located beneath the regression coefficients. *, ** and *** indicate significance at the 10, 5 and 1 % levels, respectively.

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Constant	1.881*** (0.193)	3.905*** (0.333)	3.339*** (0.277)	-1.747 (2.172)	-1.841*** (0.559)	1.109 (0.692)	-12.65*** (0.959)	-12.19*** (1.046)	-13.07*** (1.138)
FV _{t-1}	0.755*** (0.017)	0.673*** (0.0087)	0.709*** (0.0091)	0.615*** (0.027)	0.671*** (0.0086)	0.664*** (0.0093)	0.455*** (0.012)	0.459*** (0.013)	0.457*** (0.013)
Own	4.501*** (1.175)	4.837*** (0.670)			4.336*** (0.827)	2.293*** (0.858)	5.654*** (0.789)	5.851*** (0.796)	6.691*** (0.844)
Own ²	-6.254*** (1.496)	-6.375*** (0.886)			-5.779*** (1.088)	-4.028*** (1.091)	-6.793*** (1.002)	-7.113*** (1.023)	-8.009*** (1.089)
<i>Critical Value Own</i>	<i>0.360</i>	<i>0.379</i>			<i>0.375</i>	<i>0.285</i>	<i>0.416</i>	<i>0.411</i>	<i>0.418</i>
Lev		-2.946*** (0.502)	-1.977*** (0.458)	19.05* (9.767)	24.97*** (1.926)	16.75*** (2.465)	59.85*** (3.017)	60.03*** (3.312)	61.28*** (3.456)
Lev ²				-16.42* (9.275)	-26.81*** (1.746)	-20.54*** (2.244)	-49.33*** (2.800)	-49.60*** (3.064)	-51.01*** (3.207)
<i>Critical Value Lev</i>				<i>0.580</i>	<i>0.466</i>	<i>0.408</i>	<i>0.607</i>	<i>0.605</i>	<i>0.601</i>
Div						-0.636*** (0.124)	-0.774*** (0.116)	-0.817*** (0.117)	-0.872*** (0.122)
Size							-0.261*** (0.090)	-0.346*** (0.093)	-0.307*** (0.092)
ROA							7.177*** (0.817)	7.040*** (0.861)	6.525*** (0.848)
Z							0.194*** (0.0097)	0.195*** (0.010)	0.190*** (0.0099)
IFRS								0.243*** (0.074)	0.184** (0.076)
BankConc									0.0084* (0.0046)
Obs.	4,430	4,430	4,430	4,430	4,430	4,048	4,048	4,048	4,042
Number of iden	584	584	584	584	584	558	558	558	556
Industry Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Time Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No Instruments	262	262	262	262	262	262	262	262	262
Wald test	1665.51	2242.09	2903.18	2354.08	2232.91	31861.93	5540.87	5154.17	4892.90
p-value	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
AR(1)	-4.78	-4.89	-6.61	-6.66	-4.92	-4.43	-2.51	-2.52	-2.57
p-value	0.000	0.000	0.000	0.000	0.000	0.000	0.012	0.012	0.010
AR(2)	-0.110	-0.07	0.27	0.25	-0.07	-1.05	-1.03	-1.03	-1.02
p-value	0.910	0.947	0.790	0.803	0.946	0.406	0.304	0.301	0.306
Sargan test	84.21	79.37	89.62	88.27	78.85	72.88	64.26	62.92	61.76
p-value	0.983	0.993	0.962	0.965	0.993	0.892	0.140	0.145	0.118
Hansen test	80.2	43.27	52.61	48.67	45.38	275.78	48.17	50.21	49.61
p-value	0.482	0.329	0.211	0.216	0.319	0.109	0.266	0.350	0.239
Lind-Mehlum test (Own)	12.00	3.65	-	-	5.24	2.67	6.27	6.43	6.74
p-value	0.000	0.001	-	-	0.000	0.004	0.000	0.000	0.000
Lind-Mehlum test (Lev)	-	-	-	-	12.92	6.76	13.65	12.78	12.68
p-value	-	-	-	-	0.000	0.000	0.000	0.000	0.000

Table 6. Regression Analysis. Dependent Variable is FV.

The sample includes firms from Argentina, Brazil, Chile, Colombia, Mexico, and Peru. The period is 1997-2014. The estimated regression model takes the form:

$$FV_{it} = \beta_0 FV_{it-1} + \beta_1 Own_{it} + \beta_2 Own_{it}^2 + \beta_3 Lev_{it} + \beta_4 Lev_{it}^2 + \beta_5 Div_{it} + \beta_6 Size_{it} + \beta_7 Roa_{it} + \beta_8 Risk_{it} + \beta_9 IFRS_{it} + \beta_{10} BankConc_{it} + \beta_{11} TimeDummies_t + \beta_{12} CountryDummies + \beta_{13} IndDummies + \epsilon_t + \mu_t + \xi_t$$

The table shows the regression results for the GMM System Estimator. A detailed definition of variables is provided in the Appendix. Critical Value is the threshold in the ownership concentration and leverage at which the firm value is maximized. The Wald test is a Chi squared test of the joint significance of all of the variables considered in the analysis. AR1 and AR2 correspond to the first- and second-order serial correlation tests using residuals in first differences, asymptotically distributed as N(0,1) under the null of no serial correlation. The Sargan and Hansen tests of overidentifying restrictions are asymptotically distributed as Chi-square under the null of no relation between the instruments and the error term. Lind-Mehlum's test is used to verify the inverted U-shaped relationship in the case of both the corporate ownership structure (Own) and the leverage (Lev). Standard deviations are located beneath the regression coefficients. *, ** and *** indicate significance at the 10, 5 and 1 % levels, respectively.

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Development of the Financial System						Development of the Legal and Regulatory Systems						
	Banking System			Capital Markets								
Constant	-9.488*** (1.163)	-11.36*** (1.104)	-10.64*** (1.082)	-9.921*** (1.208)	-12.55*** (1.226)	-12.46*** (1.110)	-12.69*** (1.084)	-14.78*** (1.076)	-9.229*** (1.373)	-12.17*** (1.205)	-13.94*** (1.035)	-13.62*** (1.124)
FV _{t-1}	0.416*** (0.0123)	0.437*** (0.0127)	0.446*** (0.0127)	0.458*** (0.0132)	0.446*** (0.0127)	0.447*** (0.0125)	0.450*** (0.0130)	0.439*** (0.0129)	0.459*** (0.0133)	0.455*** (0.0134)	0.455*** (0.0126)	0.451*** (0.0133)
Own	15.83*** (0.902)	11.66*** (0.898)	7.784*** (0.846)	10.75*** (0.887)	13.17*** (0.833)	9.089*** (0.805)	7.002*** (0.827)	4.200*** (0.797)	8.318*** (0.858)	6.643*** (0.872)	5.424*** (0.757)	5.626*** (0.842)
Own ²	-20.76*** (1.214)	-14.17*** (1.178)	-9.068*** (1.092)	-12.68*** (1.173)	-15.97*** (1.123)	-11.10*** (1.048)	-8.319*** (1.059)	-5.153*** (0.999)	-9.493*** (1.116)	-7.708*** (1.127)	-6.633*** (0.971)	-7.002*** (1.073)
<i>Critical Value Own</i>	0.381	0.411	0.429	0.424	0.412	0.409	0.421	0.408	0.438	0.431	0.409	0.402
Lev	61.77*** (3.274)	58.03*** (3.226)	57.10*** (3.083)	56.81*** (3.758)	57.97*** (3.449)	60.51*** (3.323)	62.92*** (3.606)	68.24*** (3.016)	57.97*** (3.821)	60.62*** (3.681)	62.40*** (3.235)	64.99*** (3.149)
Lev ²	-53.15*** (2.911)	-48.43*** (2.876)	-47.02*** (2.811)	-47.11*** (3.425)	-47.75*** (3.079)	-50.37*** (2.994)	-52.05*** (3.292)	-58.01*** (2.805)	-48.14*** (3.500)	-50.37*** (3.382)	-52.10*** (3.032)	-54.46*** (2.886)
<i>Critical Value Lev</i>	0.581	0.599	0.607	0.603	0.607	0.601	0.604	0.588	0.602	0.602	0.599	0.597
Div	-0.561*** (0.103)	-0.677*** (0.103)	-0.749*** (0.107)	-0.933*** (0.116)	-0.832*** (0.105)	-0.744*** (0.110)	-0.865*** (0.125)	-0.713*** (0.133)	-0.726*** (0.125)	-0.794*** (0.129)	-0.804*** (0.118)	-0.827*** (0.125)
Size	0.158 (0.139)	-0.0799 (0.125)	-0.218** (0.103)	-0.457*** (0.106)	-0.0735 (0.128)	-0.167* (0.0996)	-0.324*** (0.0954)	-0.214** (0.101)	-0.725*** (0.113)	-0.368*** (0.0965)	-0.226** (0.0983)	-0.341*** (0.123)
ROA	7.206*** (1.014)	7.505*** (0.902)	7.067*** (0.880)	8.599*** (0.850)	8.455*** (0.868)	6.833*** (0.865)	7.153*** (0.884)	3.957*** (0.922)	8.514*** (0.879)	7.119*** (0.858)	6.284*** (0.879)	6.985*** (0.930)
Z	0.181*** (0.0099)	0.188*** (0.0098)	0.193*** (0.010)	0.191*** (0.011)	0.194*** (0.011)	0.195*** (0.010)	0.196*** (0.010)	0.201*** (0.011)	0.185*** (0.011)	0.190*** (0.011)	0.196*** (0.010)	0.193*** (0.010)
IFRS	1.062*** (0.100)	1.003*** (0.106)	0.906*** (0.118)	0.311*** (0.086)	0.294*** (0.086)	0.115 (0.078)	0.196*** (0.073)	0.237*** (0.073)	0.261*** (0.088)	0.211** (0.083)	0.599*** (0.136)	0.437*** (0.087)
DBAGDP	-0.110*** (0.011)											
PCBGDP		-0.069* (0.009)										
BCBD			-0.025*** (0.004)									
SMKGGDP				-0.022*** (0.003)								
SMKVTGDP					-0.079** (0.008)							
SMKTO						-0.027** (0.004)						
VA							1.321** (0.393)					
PS								1.522** (0.181)				
GE									1.710* (0.344)			
RQ										0.252 (0.291)		
RL											1.335*** (0.392)	
CC												2.754** (0.321)
Observations	4,047	4,047	4,047	4,047	4,047	4,047	4,047	4,047	4,047	4,047	4,047	4,047
Number of iden	558	558	558	558	558	558	558	558	558	558	558	558
Industry Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Time Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No Instruments	262	262	224	224	224	224	224	224	224	224	224	224
Wald-test	4227.5	4468.74	4409.17	4959.23	5049.87	4882.47	4740.77	5299.02	4867.62	4778.07	4737.55	4155.79
p-value Wald-test	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
AR(1)	266.33	-2.57	-2.52	-2.56	-2.52	-2.50	-2.49	-2.42	-2.63	-2.56	-2.50	-2.52
p-value AR(1)	0.007	0.010	0.012	0.011	0.012	0.012	0.013	0.016	0.008	0.010	0.012	0.012
AR(2)	237.88	-1.04	-1.05	-1.02	-1.04	-1.04	-1.05	-1.10	-1.01	-1.03	-1.05	-1.05
p-value AR(2)	0.107	0.297	0.295	0.310	0.297	0.299	0.295	0.272	0.314	0.302	0.101	0.293
Sargan-test	203.75	205.08	203.17	200.37	200.03	202.46	201.43	201.91	202.70	202.01	201.83	209.66
p-value Sargan-test	0.118	0.158	0.150	0.132	0.184	0.110	0.112	0.211	0.210	0.211	0.211	0.214
Hansen-test	34.14	41.03	38.13	45.52	40.01	42.14	46.56	43.52	52.17	49.20	43.78	33.17

p-value Hansen-test	0.319	0.291	0.305	0.357	0.291	0.276	0.252	0.368	0.231	0.241	0.266	0.352
Lind-Mehlum test (Own)	16.18	11.07	7.48	9.64	12.68	9.68	7.17	4.86	7.48	6.14	6.33	6.17
p-value	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Lind-Mehlum test (Lev)	15.72	14.02	13.17	11.24	12.74	13.88	12.62	16.57	11.13	11.95	13.44	15.10
p-value	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

This table continues from the previous page.

Table 7. Principal Component Factoring (PCF) Analysis.

The table shows the results for the analysis of the principal component factoring applied to the external variables of corporate governance. Panel A shows the factor analysis for the financial development variables (DBAGDP, PCBGDP, BCBD, SMKGDP, SMKVTGDP, and SMKTO); whilst Panel B displays the factor analysis the legal and regulatory systems variables (VA, PS, GE, RQ, RL, and CC).

Panel A: Financial Development Variables					
Variables	Factor	Eigenvalue	Difference	Proportion	Cumulative
DBAGDP	Factor1	4.450	3.677	0.742	0.742
PCBGDP	Factor2	0.774	0.124	0.129	0.871
BCBD	Factor3	0.650	0.566	0.108	0.979
SMKGDP	Factor4	0.084	0.056	0.014	0.993
SMKVTGDP	Factor5	0.028	0.014	0.005	0.998
SMKTO	Factor6	0.014	.	0.002	1.000
Panel B: Legal and Regulatory Systems Variables					
VA	Factor1	3.176	1.631	0.529	0.529
PS	Factor2	1.544	0.810	0.257	0.787
GE	Factor3	0.734	0.499	0.122	0.909
RQ	Factor4	0.235	0.071	0.039	0.948
RL	Factor5	0.165	0.018	0.027	0.976
CC	Factor6	0.146	.	0.024	1.000

Table 8. Regressions with Factors form PCF Analysis.

The sample includes firms from Argentina, Brazil, Chile, Colombia, Mexico, and Peru. The period is 1997-2014. The estimated regression model takes the form:

$$FV_{it} = \beta_0 FV_{it-1} + \beta_1 Own_{it} + \beta_2 Own_{it}^2 + \beta_3 Lev_{it} + \beta_4 Lev_{it}^2 + \beta_5 Div_{it} + \beta_6 Size_{it} + \beta_7 Roa_{it} + \beta_8 Risk_{it} + \beta_9 IFRS_{it} + \beta_{10} BankConc_{it} + \beta_{11} TimeDummies_t + \beta_{12} CountryDummies + \beta_{13} IndDummies + \epsilon_t + \mu_t + \epsilon_{it}$$

The table shows the regression results for the GMM System Estimator. A detailed definition of variables is provided in the Appendix. Critical Value is the threshold in the ownership concentration and leverage at which the firm value is maximized. The Wald test is a Chi squared test of the joint significance of all of the variables considered in the analysis. AR1 and AR2 correspond to the first- and second-order serial correlation tests using residuals in first differences, asymptotically distributed as N(0,1) under the null of no serial correlation. The Sargan and Hansen tests of overidentifying restrictions are asymptotically distributed as Chi-square under the null of no relation between the instruments and the error term. Lind-Mehlum's test is used to verify the inverted U-shaped relationship in the case of both the corporate ownership structure (Own or PcShCIHId) and the leverage (Lev). Standard deviations are located beneath the regression coefficients. *, ** and *** indicate significance at the 10, 5 and 1 % levels, respectively.

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)
Constant	-13.99*** (1.302)	-14.32*** (1.277)	-15.14*** (1.571)	-0.246 (0.534)	-1.196*** (0.435)	-3.029*** (0.570)
FV _{t-1}	0.440*** (0.0128)	0.439*** (0.0137)	0.424*** (0.0138)	0.417*** (0.00478)	0.368*** (0.00625)	0.374*** (0.00689)
Own	13.79*** (0.925)	6.105*** (0.865)	14.26*** (0.955)			
Own ²	-16.82*** (1.245)	-7.381*** (1.075)	-17.58*** (1.253)			
<i>Critical Value Own</i>			<i>0.410</i>	<i>0.414</i>	<i>0.406</i>	
PcShCIHId				11.20*** (0.479)	12.02*** (0.449)	10.22*** (0.519)
PcShCIHId ²				-11.04*** (0.356)	-10.84*** (0.407)	-9.715*** (0.430)
<i>Critical Value PcShCIHId</i>				<i>0.507</i>	<i>0.554</i>	<i>0.526</i>
Lev	57.18*** (3.326)	68.54*** (3.541)	61.01*** (4.061)	27.20*** (0.524)	33.43*** (0.628)	34.33*** (0.679)
Lev ²	-47.68*** (2.976)	-58.04*** (3.248)	-51.51*** (3.548)	-27.23*** (0.553)	-31.57*** (0.702)	-33.32*** (0.673)
<i>Critical Value Lev</i>				<i>0.600</i>	<i>0.590</i>	<i>0.592</i>
Div	-0.720*** (0.101)	-0.801*** (0.139)	-0.636*** (0.127)	-0.679* (0.0089)	0.558 (0.0215)	0.584 (0.0224)
Size	-0.0502 (0.131)	-0.266** (0.118)	0.0243 (0.147)	-0.632* (0.0518)	-0.801 (0.0484)	-0.475** (0.0602)
ROA	8.538*** (0.896)	6.806*** (0.905)	9.086*** (0.916)	11.96*** (0.189)	11.39*** (0.281)	11.47*** (0.282)
Z	0.188*** (0.0103)	0.192*** (0.0108)	0.180*** (0.0117)	-0.0020** (0.0004)	-0.0013* (0.0004)	-0.0016 (0.0005)
IFRS	0.794*** (0.0959)	0.360*** (0.0924)	0.911*** (0.119)	1.639*** (0.0739)	1.936*** (0.0758)	2.479*** (0.0790)
FinDevFactor1	-1.450*** (0.166)		-1.510*** (0.160)	-1.285*** (0.0297)		-1.350*** (0.0444)
LegalEnvFactor1		1.077** (0.131)	0.972*** (0.134)		1.363* (0.0463)	1.075** (0.0411)
LegalEnvFactor2		0.400*** (0.0848)	0.388*** (0.0878)		0.712** (0.0231)	0.992* (0.0250)
Observations	4,047	4,047	4,047	2,616	2,580	2,580
Number of iden	558	558	558	486	486	486
Industry Effect	Yes	Yes	Yes	Yes	Yes	Yes
Temporal Effect	Yes	Yes	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes	Yes	Yes
No Instruments	224	224	224	271	262	262
Wald-test	4626.50	4710.29	4379.06	139494.95	60647.54	208039.40
p-value Wald-test	0.000	0.000	0.000	0.000	0.000	0.000
AR(1)	-2.57	-2.51	-2.63	-3.96	-3.90	-3.90
p-value AR(1)	0.010	0.012	0.008	0.000	0.000	0.000
AR(2)	-1.04	-1.08	-1.06	-2.67	-2.92	-2.79
p-value AR(2)	0.300	0.280	0.290	0.208	0.103	0.125
Sargan-test	62.24	59.23	59.43	39.22	52.45	37.01
p-value Sargan-test	0.211	0.213	0.211	0.500	0.250	0.330
Hansen-test	237.71	241.85	231.16	278.91	275.40	280.23
p-value Hansen-test	0.109	0.171	0.151	0.189	0.120	0.178
Lind-Mehlum test (Own or PcShCIHId)	12.24	6.47	12.97	23.37	24.96	19.69
p-value	0.000	0.000	0.000	0.000	0.000	0.000
Lind-Mehlum test (Lev)	13.31	14.49	12.70	44.38	35.17	41.38
p-value	0.000	0.000	0.000	0.000	0.000	0.000

Table 9. Regressions by Institutional System

The sample includes firms from Argentina, Brazil, Chile, Colombia, Mexico, and Peru. The period is 1997-2014. The estimated regression model takes the form:

$$FV_{it} = \beta_0 FV_{it-1} + \beta_1 Own_{it} + \beta_2 Own_{it}^2 + \beta_3 Lev_{it} + \beta_4 Lev_{it}^2 + \beta_5 Div_{it} + \beta_6 Size_{it} + \beta_7 Roa_{it} + \beta_8 Risk_{it} + \beta_9 IFRS_{it} + \beta_{10} BankConc_{it} + \beta_{11} TimeDummies_t + \beta_{12} CountryDummies + \beta_{13} IndDummies + \epsilon_t + \mu_t + \varepsilon_{it}$$

This table includes the regressions by institutional system. The sample was split in two groups based on the efficiency of the legal system (LegalSys) by country (see Table 3, Panel B). The first group with relatively better legal system includes Brazil and Chile; while Argentina, Colombia, Mexico and Peru (Other Countries) were incorporated in the second group. A detailed definition of variables is provided in the Appendix. Critical Value is the threshold in the ownership concentration and leverage at which the firm value is maximized. The Wald test is a Chi squared test of the joint significance of all of the variables considered in the analysis. AR1 and AR2 correspond to the first- and second-order serial correlation tests using residuals in first differences, asymptotically distributed as $N(0,1)$ under the null of no serial correlation. The Sargan and Hansen tests of overidentifying restrictions are asymptotically distributed as Chi-square under the null of no relation between the instruments and the error term. Lind-Mehlum's test is used to verify the inverted U-shaped relationship in the case of both the corporate ownership structure (Own or PcShCIHld) and the leverage (Lev). Standard deviations are located beneath the regression coefficients. *, ** and *** indicate significance at the 10, 5 and 1 % levels, respectively.

VARIABLES	(1)	(2)	(3)	(4)
	Brazil+Chile	Other Countries	Brazil+Chile	Other Countries
Constant	0.505*** (0.054)	-56.290*** (0.078)	3.146*** (0.137)	-45.010*** (0.389)
FV _{t-1}	0.082*** (0.001)	0.309*** (0.001)	0.156*** (0.002)	0.175*** (0.002)
Own	3.828*** (0.019)	25.03*** (0.035)		
Own ²	-4.494*** (0.023)	-29.54*** (0.039)		
<i>Critical Value Own</i>		<i>0.426</i>	<i>0.424</i>	
PcShCIHld			1.419* (0.065)	-0.266 (0.392)
PcShCIHld ²			-1.466** (0.0620)	-2.440*** (0.321)
<i>Critical Value PcShCIHld</i>		<i>0.484</i>		
Lev	3.481*** (0.060)	175.8*** (0.256)	12.38*** (0.253)	165.2*** (0.683)
Lev ²	-3.421*** (0.0353)	-145.1*** (0.210)	-10.75*** (0.237)	-128.0*** (0.387)
<i>Critical Value Lev</i>		<i>0.509</i>	<i>0.606</i>	<i>0.576</i>
Div	0.398*** (0.007)	-0.875*** (0.003)	-0.380 (0.015)	0.753*** (0.023)
Size	0.179 (0.007)	-0.590* (0.007)	-0.288*** (0.013)	-0.192*** (0.050)
ROA	19.69*** (0.043)	3.387*** (0.025)	17.85*** (0.040)	-5.181*** (0.179)
Z	0.0552*** (0.001)	0.257*** (0.001)	-0.00189*** (3.34e-05)	0.482*** (0.001)
IFRS	0.719*** (0.004)	1.083*** (0.025)	1.206*** (0.016)	2.235*** (0.084)
FinDevFactor1	-1.536*** (0.006)	7.403* (0.022)	-2.022*** (0.013)	1.505*** (0.191)
LegalEnvFactor1	0.287*** (0.007)	4.230*** (0.009)	0.167*** (0.013)	2.199*** (0.036)
LegalEnvFactor2	0.465*** (0.002)	1.766*** (0.003)	1.447*** (0.004)	1.407*** (0.014)
Observations	2,357	1,690	1,788	792
Number of iden	306	252	294	192
Industry Effect	Yes	Yes	Yes	Yes
Temporal Effect	Yes	Yes	Yes	Yes
Country FE	Yes	Yes	Yes	Yes
No Instruments	224	224	260	235
Wald-test	41400	73600	46700	10200
p-value Wald-test	0.000	0.000	0.000	0.000
AR(1)	-3.44	-1.57	-1.55	-2.50
p-value AR(1)	0.001	0.117	0.120	0.012
AR(2)	0.47	-1.07	-2.13	-0.48
p-value AR(2)	0.635	0.285	0.133	0.631
Sargan-test	60.12	33.39	13.01	32.20
p-value Sargan-test	0.120	0.188	0.505	0.144
Hansen-test	241.87	206.46	212.19	129.64
p-value Hansen-test	0.165	0.556	0.942	0.855
Lind-Mehlum test (Own or PcShCIHld)	176.47	613.27	240.20	-
p-value	0.000	0.000	0.000	-
Lind-Mehlum test (Lev)	12.66	637.87	39.25	240.90
p-value	0.001	0.000	0.000	0.000

Appendix

Firm Value:

$$FV = \frac{MkCptz_{it} + TD_{it}}{TA_{it}}$$

Where $MkCptz_{it}$ corresponds to the market capitalization of the firm i in year t . TD_{it} is the total liabilities and TA_{it} is the firm's total assets.

Corporate ownership structure:

- i) OWN corresponds to the percentage of outstanding shares in hands of the controlling shareholder.
- ii) $INSOWN$ is the percentage of closely held shares which includes the shares in hands of executives and the controlling shareholder.

Capital structure:

$$Lev = \frac{TD_{it}}{TA_{it}}$$

Dividend Policy:

$$Div = \frac{DPS_{it}}{EPS_{it}}$$

Where DPS_{it} is the annual dividend per share and EPS_{it} is the earnings per share.

Firm Size:

$$Size = Ln(TA_{it})$$

Profitability:

$$ROA = \frac{EBT_{it}}{TA_{it}}$$

Where EBT_{it} is the pretax income.

Insolvency Risk:

$$Z = 6.56WC_{it} + 3.26RE_{it} + 6.72EBIT_{it} + 1.05BvE_{it} + 3.25$$

Where WC_{it} is the working capital over total assets, RE_{it} is the retained earnings over total assets, $EBIT_{it}$ is the earnings before interest and taxes, and BvE_{it} is the book value of equity over total liabilities.

IFRS:

$$IFRS_{it} = \begin{cases} 1, & \text{if the company uses IFRS} \\ 0, & \text{if the company does not use IFRS} \end{cases}$$

Where *IFRS* is the International Financial Reporting System.

Legal and Regulatory Systems:

All the following legal system variables were obtained from Kaufmann et al. (2011) where the indexes range from approximately -2.5 (weak) to 2.5 (strong) governance performance, although for our sample these variables do not have such extreme values.

- i) *VA* measures the Voice and accountability.
- ii) *PS* measures the Political stability and absence of violence/terrorism
- iii) *GE* measures the Government effectiveness.
- iv) *RQ* measures the Regulatory quality
- v) *RL* measures the Rule of law
- vi) *CC* measures the Control of corruption

Bank Concentration:

BankConc is the market share of the three largest banks by country

Financial Development:

All the following financial development variables were obtained from Beck et al. (2000).

- i) *DMBAGDP* is the claims on domestic real nonfinancial sector by deposit money banks as a share of GDP, calculated using the following deflation method: $\frac{0.5 \left[\frac{F_t}{P_{et}} + \frac{F_{t-1}}{P_{et-1}} \right]}{\left[\frac{GDP_t}{P_{at}} \right]}$, where *F* is deposit money bank claims, *P_e* is end-of period Consumer

Price Index (CPI), and *P_a* is average annual CPI.

- ii) *PCOFIGDP* is the Private credit by deposit money banks and other financial institutions as a share of GDP, calculated using the following deflation method: $\frac{0.5 \left[\frac{F_t}{P_{et}} + \frac{F_{t-1}}{P_{et-1}} \right]}{\left[\frac{GDP_t}{P_{at}} \right]}$; where *F* is the credit to the private sector, *P_e* is end-of period

Consumer Price Index (CPI), and *P_a* is average annual CPI.

- iii) *BCBD* is the private credit by deposit money banks as a share of demand, time and saving deposits in deposit money bank.

- iv) *SMKGDGP* which is the value of listed shares to GDP, calculated using the following deflation method: $\frac{0.5 \left[\frac{F_t}{P_{et}} + \frac{F_{t-1}}{P_{et-1}} \right]}{\left[\frac{GDP_t}{P_{at}} \right]}$; where *F* is the stock market capitalization, *P_e* is end-

of period CPI, and *P_a* is average annual CPI.

- v) *SMKVTGDP* is the total shares traded on the stock market exchange to GDP.

- vi) *SMKTO* is the ratio of the value of total shares traded to average real market capitalization, the denominator is deflated using the following method: $\frac{\frac{T_t}{P_{at}}}{0.5 \left[\frac{M_t}{P_{et}} + \frac{M_{t-1}}{P_{et-1}} \right]}$;

where *T* is total value traded, *M* is the stock market capitalization *P_e* is end-of period CPI, and *P_a* is average annual CPI.

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