Chapter 1. Introduction. A Study of Colombian Business Groups

'Why does big business tend to organise as business groups in so many countries, and why are many of these groups so resilient?' (Barbero & Puig, 2016, p. 6)

1.1. Introduction

In 1982, a few years after the first, and only, official report on Colombian business groups (SuperSociedades, 1975/1978), the economic and business news was filled with reports on both the Latin American debt crisis and the government's intervention in the financial system, specifically the closure of a recently consolidated major financial business group (Agudelo, 1983; H. Echavarría, 1983). Encouraged by a coffee bonanza, expanding cities, and financial reforms, the years between 1950 and 1980 saw the formation of an increasing number of business groups and the consolidation of an ownership network (Kogut, 2012) that persists today. However, the evolution of Colombian business groups in this period is still a relatively unexplored topic.

Although a few studies of (successful) large group-affiliated firms have revealed some patterns in the development of the Colombian business system during this period, the business groups remain largely ignored by business historians, economists, and management scholars. Few scholars have studied the business groups beyond the common perception of them as being the 'owners of the country' (Silva Colmenares, 1977), to date, the historical perspective on their relationship with the evolving financial system, has not been the subject of any academic study.

As a result, this thesis offers a new interpretation of the rise of Colombia's business groups during the second half of the twentieth century. Previous explanations have included the persistence of the traditional pattern of association among Colombian entrepreneurs to reduce risk and uncertainty (Álvarez, 2003), the relative importance of some powerful families mixed with cartel agreements to protect regional industries during the mid-1970s (Silva Colmenares, 1977, 2004), and a late-1980s wave of mergers and acquisitions (J. Fernández, 1995). This research, by contrast, draws on the international literature to interpret the increased number of business groups – from the four identified in 1950 to 25 in 1980 – as being the outcome of the progressive growth of entrepreneurial families (P. Fernández & Lluch, 2015), who strengthened their economic activities by increasing the creation and acquisition of firms in different industries (Chapter 4). This, tied to investments in new financial institutions (Chapter 5), resulted in the creation of internal capital markets (La Porta et al., 2003) and the 'colonisation' of the capital market (Chapter 6) as an answer to restricted access to capital (Khanna & Yafeh, 2007).

This research shows, that it was between 1950 and 1980 when large firm owners gave origin to, and strengthened, the business group form as a large, highly diversified (commonly with firms in unrelated industries), often family-controlled organisation with a (more often than not) pyramidal ownership structure. The beginning of the second half of the twentieth century was marked by the arrival of the first ever International Bank for Reconstruction (World Bank) survey mission to a 'developing' country; it promoted reforms that championed private sector activities in finance, construction, and manufacturing (Currie, 1950). Thus, during the following three decades, larger firms consolidated under commercial legislation issued in 1951 that reinforced the public limited company (*sociedad anónima*), encouraging the formation of highly diversified portfolios.

This thesis consists of seven chapters. After this introduction, Chapter 2 discusses the theoretical background. Chapter 3 outlines the major characteristics of the Colombian economy. Chapter 4 presents a typology for the study of business groups and draws on it to present a picture of the business groups studied here from 1950 to 1980, detailing their characteristics and evolution under four dimensions. Chapters 5 and 6 answer the main concern of this thesis: the relationship between the changes in financial legislation and the business groups. Specifically, Chapter 5 deals with the ways firms financed their investment and the effects of the new financial institutions on the creation of internal capital markets, while Chapter 6 focuses on the effects of the increased number of business groups on the country's two small regional stock markets. Finally, a conclusion on the thesis' main contributions and limitations, as well as the agenda for future research, is provided in Chapter 7.

The remainder of this introduction first discusses the thesis' justification. Section three presents the contribution. Section four introduces to the methodology and sources. Section five goes on to give a more detailed outline of each chapter.

1.2. Justification

To undertake economic activities, including the creation of business groups, entrepreneurs need capital, yet the interplay between finance and the dynamics affecting corporate governance is only recently beginning to get attention in Latin America. Interestingly, the existing literature (e.g. Haber, 1989; Maurer, 2002; Triner, 2000) draw attention to the need to study the access of business groups to credit. Musacchio (2009, p. 233) discusses the need to understand their 'capacity to buy or outperform their capital-starved competitors', which meant they 'ended-up dominating and controlling large portions of the internal market'. Moreover, the interconnections of the business elite with finance and the links between the financial and non-financial sectors (e.g. Marichal, 2014; Marichal & Ludlow, 1986; Miller, 2010b) have also been emphasised in the research agenda on Latin America. While Marichal and Ludlow (1986) discuss the links between the banking system and elites, Marichal (2014) argues for the need to explore the interlinks between the development of finance and the evolution of business (as family firms, business groups, and state-owned enterprises).

In the case of Colombia, this focus seems particularly important because business groups formed at the same time as the country was pursuing further financial development. While Colombia was not unique in this, the formation of its business groups does have specific characteristics that make it worthy of further study.

Between 1950 and 1980 Colombia underwent four major financial reforms. In 1951 the Central Bank's functions were altered to reduce credit rationing, in 1959 the government allowed regional investment banks to form, in 1960 it authorised the creation of investment funds, and in 1972 building societies were permitted. The aim of the potential adjustments was to spur the activities of entrepreneurs and achieve higher rates of development. The reforms promoted public limited companies as means towards the 'democratisation of ownership', yet they indirectly acted as incentives for the creation of business groups, thereby producing unforeseen results, such as the emergence of powerful economic agents and the consolidation of an oligopolistic financial system that championed a restricted group of firms. The reforms led to the emergence of specific dynamics within the private sector, such as the creation of internal markets and strong business networks that spanned across the country.

Using Colombia's business groups as a case study thus has considerable relevance for wider debates about economic development. As Leff (1978, p. 665) pointed out in his seminal study of business groups, 'entrepreneurship is likely to be more necessary for output expansion and structural change' in emerging countries. Yet, following Baumol (1990) distinction between productive, unproductive, and destructive entrepreneurial activities, research in the last two decades has demonstrated that productive entrepreneurship cannot be taken for granted (e.g., Manolova & Yan 2002; Peng, 2000). Therefore, it is important to understand the factors behind the creation of a specific business system and the (often unintended) consequences of policy decisions to modernise entrepreneurship (Gerschenkron, 1966) through an increased access to capital sources. Assuming changes in the firm structure are innovations (Schumpeter, 1934), the creation of business groups is an entrepreneurial activity that can have significant effects in emerging economies, as shown here for Colombia.

1.3. Contribution

The contribution of this thesis has three aspects. First, uses business history to understand the ownership network of a emerging country, adding to the growing literature on business groups around the world. It analyses the groups and their group-affiliated firms during a somewhat neglected period in the literature and finds that it was during this period when the seeds were planted for an increased concentration of ownership, largely as an unintended consequence of government intervention in the financial market. This result, contradicts the general assumption in the literature that development reduces the number of business groups, as the quantity and size of large corporations increases (Chandler, 1962, 1977; Collis et al., 2018; Morck & Steier, 2005; Morck et al., 2005). As shown in the case of Colombia, the ownership network created by business groups consolidates further in time.

Second, makes a contribution to the literature on financial development in Latin America. As the leader of a business group explained in an interview, 'the financial reforms with no control or legislation over the uses of credit added to the liquidity in the market, giving us [the largest firms] the chance to invest in other industries while growing in our core sector. We created groups because we did not know what else to do with the money' (Londoño, 2006, p. 2). By discussing the role of finance in the expansion of business groups, the thesis shows how legislation and restricted access to capital in the private sector limited the democratisation of ownership.

Finally, proposes a typology for future data collection on business groups across Latin America that would go beyond the focus on case studies, since it would facilitate a more comprehensive analysis of groups across the region. The Colombian dataset is in itself a contribution to the business and economic history literature; indeed, its scale and scope means that this thesis alone cannot fully exploit its potential. Using the typology to compile data on group-affiliated firms and business groups across the region would provide a resource for further comparative studies.

In making these contributions, this thesis offers new evidence that is not only relevant to discussions about the role of business groups in Colombia, but more broadly to discussions about the role of the state, finance, and the private sector in promoting economic development (Gerschenkron, 1962). For Colombia's historiography, it pushes forward Brando (2012) argument on the limited existence of the import substitution industrialisation (ISI) model in the country, by showing that the few state initiatives to promote domestic manufacturing were, to a large extent, captured by a portion of the private sector represented by the group-affiliated firms.

Here, the thesis brings a new study of ownership networks to the Latin American literature, which is still debating their positive and negative roles within business groups and the economy (e.g. La Porta et al., 2003; Maurer, 2002). The patterns followed by the banking relationships, ownership concentration, and the investment arrangements of the largest firms had a profound impact on the ability of the private sector to generate funds and create a strong organisational structure.

On a broader level still, this research draws attention back to the role of the entrepreneur, rather than focusing on the developmental state as a principal agent of economic change. While the existing literature has tended to focus on the role of entrepreneurship, small firms, networks, and alliances in emerging countries, it is important to also understand the influential role of ‘big players’, represented in this case by the business groups. As Chandler et al. (1997) argue for large industrial enterprises, firms are a key microeconomic agent and exploring how they emerged and evolved in various settings constitutes a significant part of the modern development of both the national and international economies. Combined with the assumption that the role of bankers in screening and then funding entrepreneurs is vital to stimulating economic growth, the financial dimension of corporate governance helps to explain how firms have tailored their strategies to keep operating. The adjustments of their strategies within a context of financial reform gave shape to what are now the typical corporate governance practices in Colombia. The link between the business groups, the banking system, and the capital market is stronger than it often seems in the literature. The thesis therefore focuses on how the business groups interact with financial markets, rather than finding all the determinants that shaped them. In this way, it takes a step back from explaining their internal configuration exclusively through the political economy or family business literature, according to which the business groups respectively prevailed through crony capitalism or for hereditary reasons. Nonetheless, the thesis remains aware of the importance of the role of the state in the economy and the persistence of family ownership in Colombia.

1.4. Methods and sources

This thesis uses a mixed methodology. A qualitative analysis using newspapers, published studies, and case studies is used for the historical analysis. A quantitative analysis with descriptive statistics and a panel regression is then used to understand the effects of the changes in the financial legislation. This, draws on an original database of 25 business groups and 428 group-affiliated firms as listed in Table 1.1. The information was compiled from the annual financial reports of group-affiliated firms and commercial banks, which have mainly been collected from two government agencies (see Appendix A with the list of variables and sources). Here the qualitative and quantitative data will be discussed in turn.

Table 1.1.
Sample of domestic privately-owned business groups and their group-affiliated firms in Colombia

No.	Business group	Number of group-affiliated firms	Assets in 1975 (million COP)
1	Grupo Santo Domingo	82	16,880
2	Organización Ardila Lulle	50	8,815
3	Grupo Empresarial Antioqueño	43	8,730
4	Organización Sarmiento Angulo	13	8,230
5	Grupo Mayaguez	9	7,814
6	Grupo Bolivar	14	6,678
7	Grupo Colpatria	7	6,540
8	Grupo Grancolombiano	18	5,356
9	Grupo Fabricato	12	4,760
10	Grupo Sanford	9	4,210
11	Grupo Inversiones TQ	5	4,150
12	Grupo Superior	5	3,650
13	Grupo Inversiones Mundial (Grupo Orbis)	12	3,458
14	Familia Gutt Haime	15	2,853
15	Cadenalco	13	2,416
16	Grupo Gilinski	7	2,356
17	Inversiones Manuelita	5	2,338
18	Grupo Colombina	6	1,954
19	Organización Carvajal	12	1,450
20	Cementos Samper (Manufacturas de Cemento)	16	1,381
21	Organización Corona	23	1,150
22	Grupo Espinosa	25	1,102
23	Organización Chaid Neme Hermanos	11	988
24	Grupo Casa Toro	7	754
25	Grupo Familia Puyana	12	178.4

Source: Compiled by the author from Rodriguez-Satizabal (2020).

1.4.1. *Qualitative sources*

For the qualitative data, this study relies on secondary sources with descriptions of Colombian companies and groups. Such descriptions are useful in assessing the main characteristics of the groups and are required for interpreting the quantitative data. Additional information is provided from the minutes of major banks, the economic and business press, government documents, studies of business groups and firms, and an array of other secondary sources. These materials illustrate the case studies and provide insights into the transformations of the political environment, the legislation, and the internal decisions regarding investment.

A total of 1,395 newspaper articles were used to assess information on the ownership and new investments of the groups. Through these sources, the firms owned by each group were identified under the assumption that a company was group-affiliated if one article mentioned it. Later on, the percentage of participation of the owners in the firm was evaluated with data collected from the stock exchanges, the firms, and the Superintendencias[1]. Here it is important to mention that collecting the newspaper articles was a task done by the author while working first at one of the newspapers (*Portafolio*), then at the Universidad de los Andes School of Management.

The search for articles on business groups was done in two national general interest newspapers (*El Tiempo*, *El Espectador*), two national business and economics newspapers (*Portafolio*, *La República*), three national general interest magazines (*Semana*, *Poder*, *Cambio*), and two economics magazines (*Revista Dinero*, *La Nota*). The categories for the search, both in electronic and paper archives, were: name of the ultimate owner (previously identified through the secondary sources), name of the group, and name of the firm. This search resulted

[1] Superintendencias are government agencies responsible for overseeing regulation on industries (finance, manufacturing, health, trade and transport, amongst others) in order to preserve stability, security and confidence, and to promote, organize and develop the markets.

in articles of different quality and length, the majority from the period after 1993 when the media focused its attention on the business groups. They served the purpose of helping to identify the group structure.

1.4.2. Quantitative sources

Turning to the quantitative side of the research, compiling, processing, and analysing the new database is in itself a step forward in the study of the Colombian private sector. The data mainly come from three sources: i) the Superintendencia de Sociedades (SuperSociedades), ii) Asobancaria, and iii) the Banco de la República. The first institution is the government agency responsible for inspecting and overseeing larger unlisted firms since 1931 and public limited companies since 1979; the archives of the Bogotá Stock Exchange between 1960 and 1979 are there. The second is the banking business association created in 1936, which produces statistics on the commercial banks. The last institution is the Central Bank, in which statistical information for the period resides, including data on the stock exchanges.

The dataset is in large part based on the information collected from the SuperSociedades, which requires companies to annually report their balance sheets and income statements in a common format that includes 90 variables for the balance sheet and 12 variables for the income statement. The latter is in practice a summary of the main accounts of revenue and expenditure flows, which gives a great amount of financial data for the companies. In addition to the statements, there is a file that reports the company’s legal status. Another file records information on shareholders: names of the largest and the number of shares. In some cases, there is an annex on the names of the board of directors, but these are not usually disclosed.

Finally, to show the results of their task overseeing companies, the SuperSociedades has published since 1940 two magazines with the aggregate results of the registered firms (*Revista de la SuperSociedades* and *Boletín de la SuperSociedades*). Complemented with the *Anuario Estadístico* published by the Contraloría General de la República, a government agency created in 1922, this source helps with gathering the list of firms registered. In addition to the reports on the non-financial firms, information was gathered from AsoBancaria to identify the building societies and commercial and investment banks. The annual reports to the AsoBancaria include financial institutions' balance sheets and income statements under a common format that includes 39 variables.

1.4.3. Data limitations

There are four details in the data worth introducing. First, the number of firms registered in the SuperSociedades do not account for the total number of firms created or active annually in the country. The total number of firms is registered in the Chambers of Commerce; the companies overseen by the SuperSociedades are those in which one owner holds more than 20 per cent of the capital and are involved in non-financial sectors. The number registered grew during the period from 1,352 firms in 1950 to 3,506 in 1974. Although this could be a result of an increase in the information submitted by the companies, it is also explained by changes in the legislation (in 1967 and 1971) that included adjustments to the characteristics of the firms that should be overseen by the SuperSociedades.

Second, although most of the financial statements remain in the SuperSociedades archives, there are companies that failed to report the information for several years. This could be a result of the closure, merger, or acquisition of the company, or simply that the firm did not send the information properly. Another problem is that in some cases the companies changed their registration name, mainly to deal with the inclusion of new partners or to avoid dissolution. As a result, the use of qualitative sources, such as the description of the companies, is needed to produce a more precise representation and to complete the financial information. This feature is important from the selection bias standpoint. Considering other sources and the information registered in the SuperSociedades, the data include a variable for the successful and failing cases according to the status and the changes in ownership, when it is possible.

Third, the data rely heavily on manufacturing firms, basically due to the structure of the Colombian economy and the fact that the financial sector was overseen by the SuperBancaria. In 1975, of 434 firms, 83 per cent are in the manufacturing sector, 20.3 per cent in transport, 14.1 per cent in finance, 13.9 per cent in commerce, and 5.3 per cent in others such as mining, agriculture, and construction. This confirms the pattern of the Colombian economy during the period: a decrease in the importance of agriculture and an increase in manufacturing and services. More than 40 per cent of the companies were involved in the same manufacturing sector for more than 20 years and in some cases showed characteristics of monopolistic behaviour (e.g., the brewing, soft drinks, and cement industries).

Although during the period both listed and unlisted companies were overseen by the SuperSociedades, the weight of listed companies in the sample of 428 firms used in this thesis represents in average 61 per cent of the total firms listed in the stock exchange during the period. In 1950, the sample represents 75 per cent of the total firms listed in the stock exchange, by 1975 this percentage fell to 47 per cent. This is the result of various factors: the size and locality of the stock exchanges; the size of the companies; and the fact that historically most companies overseen by the SuperSociedades are usually bond issuers rather than stock issuers due to their family ownership.

1.5. Chapter outline

At the core of this thesis is a collection of three thematically-linked but otherwise self-contained research chapters (Chapters 4, 5 and 6), which follow a review of the literature on theoretical approaches to business groups and country case studies (Chapter 2) and an overview of the historical background in Colombia (Chapter 3). Together, these contextual chapters show how the three papers together address the bigger question of the causes for the consolidation of business groups in Colombia between 1950 and 1980.

The aim of Chapter 2 is twofold. First, to note the variety of theoretical approaches to the business group to provide a framework with which to proceed with the actual question, that is, their persistence in Colombia. Second, by reiterating the importance of financing and funding, to explore the nature of the ownership network involved in this study. It is divided into three sections. It opens with a definition of the business group and discusses how country cases have influenced broad classifications. Particular importance is given to the challenges that the growth pattern of the firm has posed to the question of ownership and control.

Defining the business group has proved a challenge because of each country's specificities, so dealing with the definition brings attention to the need to recognise the patterns in each case. Understanding that there is still a broad variety of groups, the proposed variables used to define the characteristics and investigate their origins are first discussed in Chapter 2. Despite their current importance and presence since the early twentieth century, agreement on the origins of business groups around the world has not yet been reached. In the second section of Chapter 2, a review of the literature is provided to present the discussion of the origins, persistence, and financing of business groups. Most of the approaches have concluded on the importance of institutional change and family ties to explain the growth of business groups.

However, there is still the question of the role of financial legislation in stimulating further diversification through the ownership and control of firms in a variety of industries. The next section of Chapter 2 discusses the studies of Colombian business groups.

Chapter 3 discusses the historical context of Colombia's development in the second half of the twentieth century. Colombia played a distinctive role in the international context: it served as a case study for theorists of economic development and, by the end of the century, had become the crucible of the anti-drugs war led by the United States government. Hence, understanding the features that marked Colombian development is needed for the study of the evolution of business groups. Chapter 3 therefore discusses both the historical and economic studies, outlining the obstacles for economic development found in the literature, the patterns observed by the World Bank Mission, and the country's transformations during the period. The transformations witnessed between 1950 and 1980 will serve as background for the analysis of the role of finance and financial markets in shaping the business groups. The chapter is divided into five sections. It begins by discussing the arrival of the World Bank Developmental Mission and the following four sections present the patterns of Colombian development. To achieve this objective, Chapter 3 offers an overview of the most relevant processes and events influencing the country's economic development during the period. The last section concludes.

Chapter 4 answers the question: what are the characteristics of the Colombian business groups and how did they evolve between 1950 and 1985? Asking this question is a novelty for the Colombian case, since no previous study has described the business groups during their first stage of evolution. It tracks the evolution of 25 groups from their consolidation in the 1950s until 1985, a year before the Colombian government considered trade liberalisation policies for the first time. By concentrating on descriptive variables such as size, ownership and control, foundation year, and diversification, the chapter provides an overview of the consolidation, development, and restructuring of the groups. This task implies answering the underlying questions of what and who the business groups are by relying extensively on secondary literature for the main concepts and primary sources, which are valued for their 'first-handedness', in order to illustrate and complement the arguments about their characteristics. Most of the variables used to characterise the groups are the ones set out by the literature, yet the chapter also uses novel variables and indices to quantify the business groups' historical evolution and provided in the typology presented in Chapter 2 for future studies.

Chapter 5 deals first with the ways firms financed their investment under the umbrella of reforms to the credit rationing scheme. It asks: what was the relationship between the sources of capital and the creation of internal markets in business groups in Colombia? A detailed history of the evolution of the ownership schemes and capital structure of the 25 largest Colombian business groups between 1950 and 1975 answers this question. It shows that business groups in Colombia have been key players since the second half of the twentieth century, when they adopted a new organisational structure that internalised capital markets, which was made possible by new financial legislation promoted by the World Bank. Analysis of previously unknown historical evidence explains the capital structure of the group-affiliated firms. Examples of specific groups illustrate the analysis.

Chapter 6 focuses on the question: what is the role of business groups in the development of Colombia's stock markets? The literature on business groups has discussed the different ways in which they have reacted to market failures. Although the lack of developed capital markets has been included as one of the reasons why they exist, in the case of Colombia business groups pushed for the creation of stock markets to then capture them as a way to finance their investments and increase their product and geographical diversification. Chapter 5 uses panel data collected from the stock markets and historical narratives to study the uses and misuses of the stock markets by the 25 business groups. It shows how the business groups ‘colonised the capital market’ and interconnected their investments by partnering to create larger firms.

To bring together the general argument of the thesis on the close relationship between changes in the financial system and the growth pattern of the business groups in Colombia, Chapter 7 acknowledges the limitations of the study and provides a future research agenda. It argues for the importance of the collection of data on business groups in the region, in order to strengthen the literature beyond case studies.