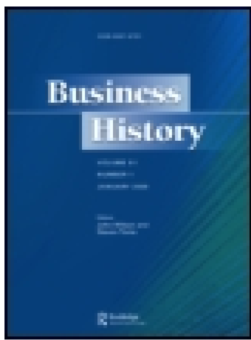

Business History

Routledge Taylor & Francis Group

ISSN: (Print) (Online) Journal homepage: https://www.tandfonline.com/loi/fbsh20

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To cite this article: Beatriz Rodriguez-Satizabal (2020): Only one way to raise capital? Colombian business groups and the dawn of internal markets, Business History, DOI: 10.1080/00076791.2020.1796973

To link to this article: https://doi.org/10.1080/00076791.2020.1796973

Published online: 05 Aug 2020.

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BUSINESS HISTORY
https://doi.org/10.1080/00076791.2020.1796973

Only one way to raise capital? Colombian business groups and the dawn of internal markets

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ABSTRACT

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 ownership schemes and capital structure of the 25 largest Colombian business groups between 1950 and 1975 answers this question. The business history and varieties of capitalism literatures have identified this organisational structure as one of the key characteristics of Latin American business and economic development. Business groups in Colombia have been key players since the second half of the twentieth century, when they adopted a new organisational structure that allowed the internalisation of capital provided 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.

KEYWORDS

Business groups; business history; Latin America; agglomeration; financial development; internal capital markets; varieties of capitalism

Introduction

Whilst the existence of business groups[1] in developing economies is not news to business historians of Latin America (Barbero & Puig, 2016), the literature on varieties of capitalism can be credited with bringing the region's business groups to the attention of a wider audience (e.g. Bull et al., 2014; Colpan & Hikino, 2018; Fernández & Lluch, 2015; Jones & Lluch, 2015; Llorca-Jana et al., 2019). What calls the attention in this literature is the recognition that many types of capitalism have coexisted and continue to coexist across countries and regions (Wilkins et al., 2010). It shows that whilst capitalism took on different forms, it evolved through the interaction between economic actors and the environment (e.g. Morck & Steier, 2005; Musacchio, 2009; Touwen, 2010). Following Hall and Soskice (2001, pp. 1–68), this article focuses on one part of this interaction: how institutions and organisations provide solutions for firms to develop and resolve coordination problems. Colombia – one of Latin America's six largest economies – provides the case study. The article studies 25 privately-owned business groups with 428 group-affiliated firms during 1950–1975. More specifically still, the article looks at the relationship between the sources of capital (promoted by changes

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in legislation) and the creation of internal capital markets (a key factor for the creation of the organisational structure) in Colombian business groups during the quest for financial reforms in the second half of the twentieth century.

Why so specific? To date, the way financial and real variables interact to form business groups in Colombia has not been the subject of academic study. This article is a first attempt to fill this gap. According to Schneider (2009) and Miller (2010), distinct characteristics of Latin American capitalism are the close relationship between the state and the business sector, and the proliferation of business groups, which resulted in a high concentration of ownership and so-called hierarchical market capitalism. To undertake entrepreneurial activities, including the creation of business groups, entrepreneurs need capital (Gerschenkron, 1962, 1966; Leff, 1978, 1979). Interestingly, the existing studies of Latin America recognise the existence of business groups and draw attention to the need to study their access to credit (e.g. Haber, 1989; Maurer, 2002; Triner, 2000). 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 have also been emphasised in the research on Latin America (e.g. Marichal, 2014; Marichal & Ludlow, 1986; Miller, 2010). Marichal and Ludlow (1986) discuss the links between the banking system and the elites, whilst Marichal (2014) argues for the need to explore the interlinkages between the development of finance and the evolution of business, whether as family firms, business groups, or state-owned enterprises.

Why the choice of Colombian business groups? Similar to other Latin American countries (e.g. Haber, 2002; Schneider, 2009), the Colombian business system evolved from stand-alone companies to diversified family business groups, multinational enterprises, and state-owned enterprises that were then privatised. However, both multinationals and state-owned enterprises played a much smaller role in Colombia than in other countries in the region (Miller, 2010). Business groups dominated for most of the second half of the twentieth century (Dávila, 2012a, 2012b), which creates a laboratory for understanding their proliferation. Recent studies have shown that features of Colombian corporate governance include high ownership concentration (Pombo & Gutiérrez, 2011) tied to the formation of business groups (e.g. Fernández, 1995; Gutiérrez et al., 2008), the evolving enforcement of legal protection for investors (Reyes, 2016), and underdeveloped equity markets (Caballero & Urrutia, 2006). Thus, how Colombia evolved from a loose aggregation of small firms to a large, complex, and highly concentrated corporate governance system merits further investigation.

As this article shows, it was during the period 1950–1975 when large firm owners – in both manufacturing and finance – consolidated the business group form as a large, highly diversified, often family-controlled organisation with hierarchical ownership structures. The beginning of the second half of the twentieth century was marked by the arrival of the first ever International Bank for Reconstruction (that is, the World Bank) survey mission to a developing economy, which promoted reforms that championed private sector activities in finance, construction, and manufacturing (Currie, 1950). During the following three decades, larger firms consolidated under commercial legislation, issued in 1951, that reinforced the public limited company (*sociedad anónima*), facilitating the formation of highly diversified portfolios.

Business groups were a response to what was the most important barrier to entry in Colombia for most of the twentieth century: access to finance, which was solved by the interactions within ownership networks, leading to the consolidation of privately-owned business groups. In this, Colombia was similar to the rest of Latin America. As Musacchio and Read (2007) have shown for the case of Brazil and Mexico, ownership networks played a crucial role during early industrialisation. Furthermore, Del Angel (2016) findings on Mexico show that ties between business groups and banks were more diverse than is commonly suggested. Similar to the case of Mexico, in Colombia financial intermediaries were initially owned by various non-financial business groups, but then came but then came to be owned by business groups specialised in finance by the end of the period. As Islas (2015) argues for the case of Chile, the groups adapted to changes in financial legislation to remain dominant even after the import-substituting industrialisation (ISI) period. Salvaj and Lluch (2012) and Salvaj and Couyoumdjian (2016) conclude that local group-affiliated firms and banks played a central role in the interlocking directorates in Chile by the end of the 1970s, but were more fragmented in Argentina. The case of Colombia shows an increasing number of business groups during the ISI years and a pattern comparable to the Chilean case.

From a theoretical perspective, the origins of the business groups may, then, reside in the entrepreneurial reaction to capital market imperfections (Khanna & Yafeh, 2007). Business groups could not have been prevalent in Colombia until the mid-twentieth century, when industrialisation reached a more advanced stage and more sources of capital were available. Even once diversification became more common, it seems that most entrepreneurs and firms found the capital to grow, in a similar manner to the largest countries in Latin America. Yet the capital provided was concentrated in a small group of entrepreneurs who formed this specific organisational structure and used new capital sources created by legislation to keep growing.

Moreover, Colombian groups show an increase in the use of their 'contact capabilities' (Guillén, 2000, 2010; Guillén & García-Canal, 2009; Kock & Guillén, 2014) to push their growth further. As a result of business and economic developments during the first wave of globalisation, from around 1870 to 1930, in the second half of the twentieth century the government acted as a rule setter, strongly promoting businesses and allowing the participation of the business elite in economic and political decision-making by naming them in ministries and as members of the board of directors in state-owned enterprises, financial institutions, and other bodies.

A look back at the economic and business history is thus needed. By analysing the 25 largest business groups, this article explains the capital structure of the group-affiliated firms through three key factors: access to finance, the cost of capital, and the firms' performance. It relies on data collected from the financial statements of the group-affiliated firms and secondary sources with descriptions of Colombian firms and groups. The 25 groups are the largest privately-owned business groups in Colombia between 1950 and 1975. Business groups were selected from Rodriguez-Satizabal (2020) dataset, which collates the financial statements and descriptive variables of Colombian business groups between 1949 and 1980. The selection is based on their size given by assets or total sales in 1975. A careful revision was made backwards to capture new and dissolved groups during the period. The analysis shows that organisational and institutional factors, specifically financial legislation, each explain part of the heterogeneity in the fate of the Colombian business groups during a period that begins with the promotion of modernisation by the World Bank's first

developmental mission, continues with a weak ISI model, and ends with a banking crisis that was begun by one particular business group (Caballero & Urrutia, 2006), Grupo Grancolombiano, in 1982.

The article is structured as follows. The next section introduces the reader to the historical background in which business groups and financial reforms flourished. It focuses specifically on the financial reforms that established the instruments for the allocation of credit and determined the mechanisms available for accessing capital, thereby making the financial system more flexible. A preliminary assessment of the sources and uses of capital for the Colombian group-affiliated firms is the subject of the first part of section two. The next section attempts to explain the capital structure of the group-affiliated firms. The last section summarises the findings and conclusions.

Pre-1950: source limitations and new research

Similar to other Latin American economies, the number and size of business groups in Colombia increased greatly during the second half of the twentieth century. Due to the availability of information, the dataset compiled by Rodriguez-Satizabal (2020) only considers the groups' that were founded, prominent, consolidated, or dissolved from 1949 to 1980. It does not include business groups consolidated and dissolved before 1949 or state- or foreign-owned groups. The information collected in the dataset shows an increasing number of business groups consolidating after 1950, more specifically from the mid-1960s, with the highest peak after 1972. This confirms the rapid growth of the family firm from stand-alone to diversified business groups during the post-war decades.

The 25 business groups and 428 group-affiliated firms selected from Rodriguez-Satizabal (2020) refer to the numbers at the end of the period 1950–1980, whilst the actual number of groups and firms varied across the years. Only 4 of the 25 groups were consolidated before 1950 and prevailed during the following years. In the case of Colombia, there is still a need in the literature to identify business groups between 1870 and 1950, the period in which Argentina, Chile, Mexico, and Brazil had a great number of groups forming. Recent studies on the German immigrant founder of Bavaria (Molina, 2019) and Jewish immigrants in Bogotá (Martínez Ruiz, 2018) have identified groups formed in Colombia during the mentioned period. Moreover, since 2018 there is ongoing research on Antioquia and Valle del Cauca's business groups in the years before 1940. There were, then, groups before 1950, but there are questions about their long-term performance and persistence.

Historical background: business groups and financial reforms

By 1950, Colombia was characterised by strong regional economies with defined business elites (Dávila, 2003; Safford & Palacios, 2002). Each region held specific groups of entrepreneurs and firms, with a concentration of the main activities in the major urban centres (Bogotá, Barranquilla, Medellín, and Cali). Given high levels of geographical fragmentation and the great distances between the main ports and large population centres, Colombia faced serious challenges. Significant improvements in transportation were indispensable to overcome geography (Ramírez, 2007). Moreover, after 1954, the economic cycle was driven by coffee exports (Ocampo et al., 1987/2007), which had an effect on the purchasing power of coffee growers and the availability of imported intermediate goods and capital.

Between 1950 and 1975, the main element of the ISI model was to internalise the production of manufacturing and consumer goods, while promoting backward integration and investment in new technologies. The movement from an agricultural and rural economy to a semi-industrial and urban economy was the most obvious transformation of these years. The result was the emergence and consolidation of new economic activities, specifically manufacturing, construction, and financial services. During the period, GDP grew by 5.1 per cent annually, multiplying about six times. Compared to other countries in Latin America, Colombia did well from 1967 on (Bértola & Ocampo, 2012). The highest growth rate was 8.4 per cent in 1973 and the lowest was 1.9 per cent in 1953. The net result of economic and population growth was an increase in output per capita by 2.3 per cent annually, which was close to the Latin American average of 2.7 per cent, and resulted in total growth of about 130 per cent over the three decades.

The manufacturing sector was the engine of economic growth, but modern services also expanded rapidly (Bulmer-Thomas, 2014, chapter 9). The decrease of the agricultural sector from 40 per cent of GDP in 1940–1945 to 24 per cent by 1975–1980 meant new economic activities such as financial services, transport, telecommunications, and public utilities saw increasing roles. By the 1960s, the manufacturing sector was already contributing 20 per cent of GDP and it rose to 29 per cent in 1975, while modern services came to represent 45 per cent (BanRep, 1930–1982). There was an increase in the number of industrial plants as an average of 130 factories were founded per year (Echavarría & Villamizar, 2007, p. 179). As the private sector built large industrial plants and warehouses, the number of vehicles increased and the stock of housing and office buildings in the cities grew sharply. Construction then expanded, becoming a key sector of the economy.

According to Misas (1973, p. 13), the expansion was accompanied by 'high private investment, some foreign direct investment, large firms' diversification and concentration into *grupos económicos*'. However, in the 1950s, the government was not expecting these future results. As the Superintendente de Sociedades[2] pointed out in a quarterly report, 'the growing number of public limited companies shows that this type of company is the most precious instrument to push economic development. Improving their conditions will result in the investment of national savings in shares' (Mejía (1959, p. 250). Accordingly, the number of companies grew from 1,352 in 1950 to 3,800 in 1980.[3] However, the impact on business groups was paramount, since the group-affiliated firms grew larger and more firms were added to the organisational structure. As a result, from 21 companies affiliated to 4 business groups in 1950, the country ended the period with 428 of the largest companies affiliated to 25 business groups.

As shown in Table 1, the number of business groups increased during the period. The 1960s saw the greatest increase in the number of groups with nine new consolidations and the appearance of the first two financial business groups, Grupo Bolívar and Grupo Grancolombiano. Only one of the 25 groups, Grupo Empresarial Antioqueño, was not family-owned, with its ultimate owners a group of regional entrepreneurs. With the exception of four business groups in the financial sector, the majority of the groups' core business was in manufacturing. Familia Puyana, Cementos Samper, and Organización Corona had their main investments in building materials. Today four are still the largest groups in the Colombian economy: Grupo Empresarial Antioqueño, Organización Sarmiento Ángulo, Organizacíon Ardila Lulle, and Grupo Santo Domingo. As a result of the regional economies, business groups are distributed among the four main economic regions: 11 in Bogotá, 7 in Medellín, 5 in Cali, and 2 in Barranquilla.

Table 1. Privately-owned business groups in Colombia by decade, 1950–1979.

Decades	No.	Consolidated business group[1]	Dissolved business group[2]
Before 1950	1	**Grupo Empresarial Antioqueño**	
	2	Grupo Familia Puyana	
	3	Organización Carvajal	
	4	Organización Corona	
1950–1959	5	Cementos Samper (Manufacturas de Cemento)	
	6	Familia Gutt Haime	
	7	Grupo Mayaguez	
	8	**Grupo Santo Domingo**	
	9	Organización Chaid Neme Hermanos	
	10	Grupo Fabricato	
	11	Grupo Colombina	
1960–1969	12	Cadenalco	
	13	Grupo Bolivar	
	14	Grupo Espinosa	
	15	Grupo Grancolombiano	
	16	Grupo Gilinski	
	17	Grupo Inversiones Mundial (Grupo Orbis)	
	18	Grupo Sanford	
	19	Inversiones Manuelita	
	20	**Organización Ardila Lulle**	
1970–1979	21	Grupo Casa Toro	
	22	Grupo Colpatria	
	23	Grupo Superior	
	24	Grupo Inversiones TQ	Grupo Familia Puyana (1981)
	25	**Organización Sarmiento Angulo**	Grupo Grancolombiano (1982)

[1]Refers to the business groups constituted during the period. A group is constituted when three firms in two different sectors are owned and controlled by the same owner.
[2]Business groups liquidated during the period. Groups highlighted correspond to the current four largest business groups.
Source: Compiled by the author from Rodriguez-Satizabal (2020).

Only one business group, Grupo Espinosa, had its core business in coffee, even though the country's economic cycle continued to be driven by coffee exports (Junguito, 1997). However, it is important to mention that five groups' core businesses were founded between 1870 and 1930, which means the initial capital came from either coffee or trade. In terms of the economic cycle, the effects of external coffee price fluctuations were twofold. First, an increase in coffee prices meant that growers had increased purchasing power and there was a rise in government revenues and expenditures, leading to higher demand for manufactured goods. Conversely, a decrease in external coffee prices had an adverse effect on domestic demand. Second, there was an effect on the availability of imported intermediate goods and capital due to shortages of foreign exchange. Whereas phases of rising coffee prices meant greater availability, low prices produced shortage. Consequently, the economic cycle was affected and the industrialisation strategy changed accordingly. Decisive until the 1960s, it weakened from 1967, and by the end of the period further openness was required.

In this context, the business groups found the relationship with a financial intermediary an essential part of their expansion through investments in sectors beyond their core business. Between 1960 and 1975, diversification into unrelated industries increased, with a peak after 1972. All the groups expanded their business to more than two industries other than the core

sector, with each developing a distinct specialty and becoming major players in their chosen industries. Organización Ardila Lülle, one of the four major groups, had investments in seven industries, covering a broad spectrum from agriculture to recreation and cultural services. Grupo Empresarial Antioqueño, Santo Domingo, Gutt, and Cadenalco had major investments in five industries. Three groups, Carvajal, Espinosa, and Sarmiento, invested in four industries; the last being the only group who turned their portfolio completely from construction companies to financial institutions. Of the remaining groups, four controlled firms among three industries (Colpatria, Grupo Grancolombiano, and Corona), and the others (Bolivar, Puyana, Mayaguez, Corona, and Espinosa) were active in only two industries.

Dynamism and evolution in financial activities broadly paralleled the course of economic change. The dominant view in the economic historiography of Colombia is that the country's financial system is small and lagged behind other economies because of the agrarian nature of the economy (Sánchez et al., 2007). Indeed, measured by the Demirguc-Kunt and Levine (1999, pp. 22–23) structure index, the Colombian financial system was still classified as bank-based and underdeveloped by the end of the century. In a group of 47 countries, Colombia is ranked among those at the lower middle level of development, as are most of the 11 Latin American countries studied. As shown in Figure 1, throughout the years 1950–1980, the financial system was bank-based. Measured as the relation between stock exchange transactions and banking credit, the increase in credit transactions was evident from 1951, only decreasing sharply in 1975.

Although the literature agrees on this classification, Caballero and Urrutia (2006, p. 35) argue that during the second half of the twentieth century financial deepening increased slightly, leading to improved provision of financial services with a wider choice of services for all levels of society. The financial reforms – specifically of the banking and capital markets – are an especially useful lens through which to view the changes in ownership structure in any country (La Porta et al., 1999). As Ocampo et al. (1987/2007) explain, industrialisation was the dominant process during the period and was accompanied by state intervention, especially in relation to trade policies, foreign transactions, and the financial system. Four major financial reforms were implemented, mainly as a result of the awareness created by

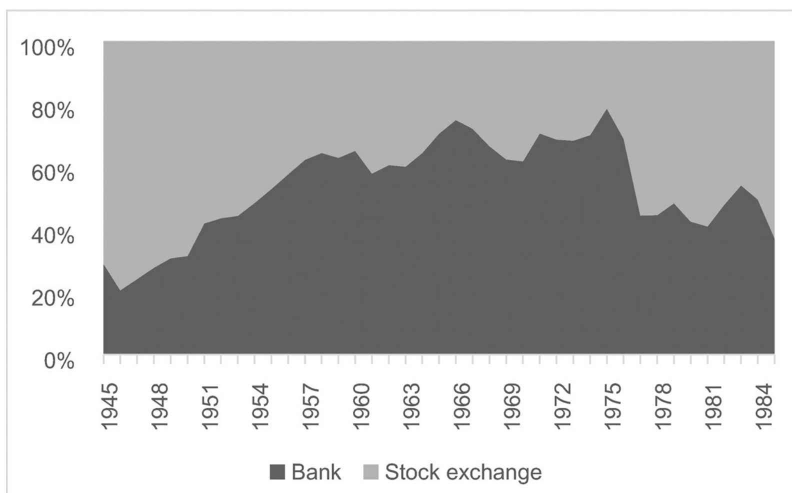

Figure 1. Financial system structure: Bank-based credit and stock exchange transactions, 1945–1985.

the World Bank mission on the need to provide sources of capital for entrepreneurs. After the reform of the Central Bank functions in 1951 to reduce credit rationing, the government allowed regional investment banks in 1959 and building societies in 1972. The aim was also to democratise ownership by increasing the number of shares owned by households; consequently, the government authorised the creation of investment funds in 1960.

At the beginning of the 1950s, then, investments requiring finance in amounts larger than could be raised by individuals and entrepreneurs within their personal networks were opportunities foregone. Currie (1950) identifies four aspects of the incipient Colombian financial system. First, the supply of short-term credit for commercial and industrial purposes was ample, yet there was great scarcity of short-term credit in agriculture. Second, funds for long-term investment in high-cost housing were available, but the supply of credit for middle- and low-cost housing was wholly insufficient. Third, while long-term funds were available in substantial amounts to establish companies with low projected profit margins, or to wealthy individuals who could reinvest their earnings, it was difficult for the outsider to secure capital from the market. Finally, the credit standing of the government, as reflected by the reluctance to hold public debt, was low.

In 1950, the government issued a law (Decreto 384) that increased the term from 150 days to 5 years for credit available for industrial purposes. According to Jaramillo (1955, p. 416), although it was not well received by the monetary authorities and represented a low percentage of the total loans, 'it was a required measure to increase the availability of capital'. The first reform of the Central Bank in 1951 spurred the greatest changes in the system during the period. Salazar (1996) maintains that, after years of active monetary and credit intervention, under the regulatory framework established by the Kemmerer Missions in 1923, there was a need for long-term financial reform. Caballero and Urrutia (2006) cite the inability to mobilise savings and channel them to more productive uses as driving the new legislation. Most of the debate was on the need to expand the Central Bank's regulation and allocation functions, the creation of new instruments of monetary regulation, and restrictions on private individuals in monetary and credit policy design. Credit supply measures were adopted and applied to provide for industrial sectors. Inspired by the belief that investment provides the seeds for industrial growth, which, in turn, fuels economic growth and prosperity, the World Bank mission considered it appropriate to modify the strict rules governing lending practices. As a result, the 1951 reform centralised financial decision-making and strengthened the promotion of credit for specific sectors.

From the 1940s onwards, the Colombian public sector provided medium- and long-term credit at less-than-market interest rates to finance priority activities, including industrial and agricultural development, urban infrastructure, and exports. However, in 1950 the financial structure of the Colombian capital market revealed a very uneven distribution of funds. When the World Bank mission arrived in 1949, the Central Bank legislation was still inspired by the principle of limiting bank lending to liquid short-term operations. In order to ensure an adequate volume of credit, bank rules only authorised commercial banks to make loans with maturities of less than one year, while prohibiting them from making investments in industrial companies or real estate. However, in the view of the World Bank mission, 'by using its power to rediscount and to change reserve requirements, the Banco de la República could exert control over commercial bank reserves and their lending capacity' (Currie, 1950, p. 295). This included rolling over loans to owners of the largest firms.

The World Bank mission considered the soundness of the banking system to depend on the maturity of the economy in general and not on the Central Bank. Therefore, the World Bank believed that in a healthy economy, long-term credits were needed and were quite compatible with a solid structure of bank assets, so the severe restrictions imposed by the law of 1923 did not have any merit as a means of automatic credit control and had gone beyond what was necessary to ensure bank liquidity, which resulted in a 'complete separation between commercial banking and capital formation' (Currie, 1950, p. 49) . Consequently, the mission considered it appropriate to reconsider 'the strict rules governing the lending practices of commercial banks' (Currie, 1950, p. 291) and suggested that the volume of credit should be controlled by the Central Bank, which would expand or restrict it as the economic situation demanded. To do so, the Central Bank could change the reserve requirements of commercial banks and provide a rediscounting facility. The Central Bank would thus continually adjust the ability of commercial banks to meet credit demand. In order to give the Central Bank the necessary freedom of action, the 1951 reform law established the bank as an autonomous entity.

All commercial banks were members of the Central Bank. Colombian banks provided an ample amount of funds to industry and trade, yet by law 'commercial banks may not grant loans of over one-year maturity and they may not invest in industrial enterprises or real estate except where such securities are offered as loan collateral' (Meisel, 1990, p. 455). Also, they were obliged to hold their required reserves, with 15 per cent as sight deposit and 5 per cent as term deposit, with the Central Bank. By using its power to rediscount and to change reserve requirements, the Central Bank could exert control over commercial bank reserves and their lending capacity. Lending by the Central Bank was aimed at providing commercial banks with additional reserve funds and at providing credit to the government.

With the reform of 1951, this panorama changed greatly. In this year, the first measures were undertaken to move the Central Bank towards assuming the role of credit supplier for the development of certain sectors of the economy. The government decided to direct the course of medium- and long-term credit towards productive activities (see Figure 2). Thus, commercial banks were authorised to grant credits with five-year maturity terms, exclusively destined for infrastructure development (electric plants and water provision), mining, agriculture, manufacture, and planned urbanisation – all sectors in which business groups expanded their activities. Commercial banks became embedded in business groups. Six banks (Banco Industrial Colombiano, Banco de Colombia, Banco Colpatria, Banco de Occidente, Banco Franco-Colombiano, and Banco Grancolombiano) were directly controlled by four groups. There were other banks controlled by several business groups or simply with directors from them.

After 1955, new instruments to channel private capital and long-term finance to manufacturing were developed (see Table 2). A development bank, the Instituto de Fomento Industrial (IFI), founded in 1940, became a strategic tool for the state's promotion of industrialisation; its objective was initially to advance risk capital to industrial investment projects. The role of the IFI in creating new manufacturing enterprises located in heavy industries was central during the 1950s and 1960s. The only other major financial intermediaries were the Caja Agraria, an official credit institution created in 1931 to provide credit to small-scale farmers that broadened to include the provision of credit to small industry and small-scale mining, as well as the Banco Central Hipotecario (BCH), an official bank created in 1932 to fulfil the full range of mortgage banking functions.

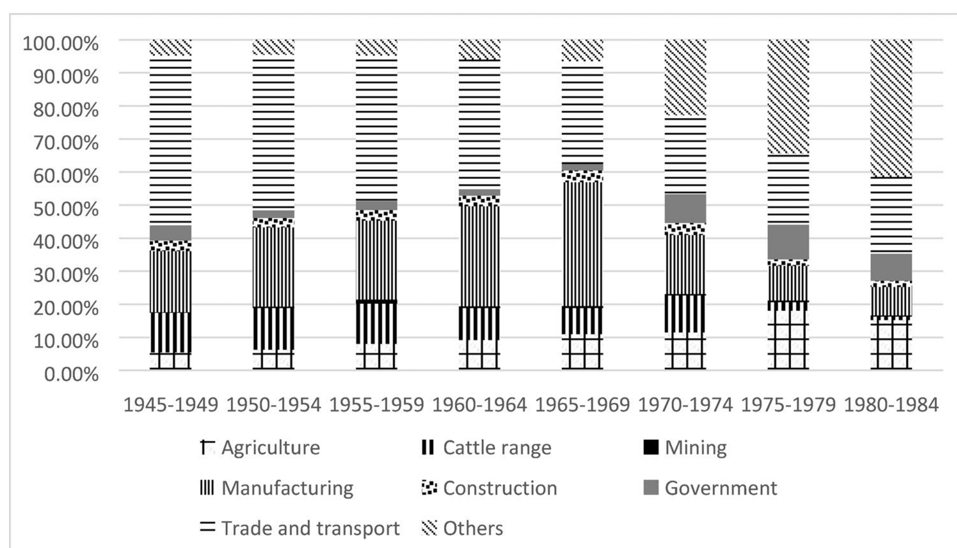

Figure 2. Credit by sector, 1945–1989.

Table 2. Characterisation of the Colombian financial system, 1945–1980[1].

	1945–1953	1954–1965	1966–1973	1974–1980
Commercial banks	13	17	25	24
Domestic	9	12	20	18
Foreign	4	5	5	6
Official banks	2	4	7	8
Regional investment banks			9	9
Building societies				12
Stock exchange	1	1	2	2

[1]The number of institutions corresponds to those at the beginning of each period.
Source: Compiled by the author based on Asobancaria (1990a); (Asobancaria, 1990b, 1990c, 1990d; BanRep, 1930–1982).

Investment banks (*corporaciones financieras*) were then created in 1959 to provide long-term credit for regional firms. Their main objective was to 'promote the creation, reorganisation, and transformation of firms (in the manufacturing, mining, and agricultural sectors), to participate in their capital or facilitate the participation of others, and to provide them credit' (Law 155 of 1959). By the end of the 1960s, there were 23 commercial banks, 9 investment banks, and two official credit institutions specialised in agriculture. Three of the investment banks were co-founded by business groups: Corporación Financiera del Norte, Corporación Financiera Colombiana, and Corporación Financiera del Valle. In the other six, ten groups had members on the board of directors.

Until the late 1960s, the financial system remained relatively simple and the functions of the different categories of credit institutions were clearly delineated. Apart from the specialised functions assigned to the two official banks, commercial banks were raising resources through checking and savings accounts and lending mainly through short-term operations, while the investment banks focussed their efforts primarily on the provision of medium- and

long-term credit to regional productive sectors and to a limited extent participated in the share capital of productive enterprises.

In 1960, the government authorised the creation of investment funds. The developmental policy was reinforced during the 1960s by means of the creation of various financial funds associated with the Central Bank, such as the funds for agriculture and cattle, private investment, industry, export promotion, and urban development. Business groups founded on average two or three private investment funds to mobilise capital within the group. Through these investment funds, the groups created 'special purpose vehicles or entities',[4] with the purpose of accessing loans in specific industries and regions. The 25 business groups created 112 special purpose entities after 1968. The companies were registered for a year, but never performed any economic activity. Instead, the special purpose entity was commonly granted loans that were later distributed across the other group-affiliated firms through equity. Then, business groups created internal capital markets using the resources provided by the government.

It was not until 1967 that the system began to be gradually liberalised. A crawling peg was established in order to reduce the incentives for capital flight in anticipation of devaluation; as a result, the attractiveness of the financial sector increased. The government created export credit certificates, the Certificados de Abono Tributario, which had a free interest rate and for which a broad secondary market was rapidly developed. In the early 1970s, the interest rates on the publicly-held government debt and BCH certificates were raised.

The government created a system of building societies, the Corporaciones de Ahorro y Vivienda, in 1972, which finally moved the system towards liberalisation. These building societies grew under a system of savings created by Lauchlin Currie and his team of Colombian economists. The returns were equal to annual inflation plus a nominal interest rate. These resources were allocated to building houses with the objective of turning the country into a nation of homeowners, leading to an increase in the number of saving banks and a change in the structure of the building sector. During this period, the Central Bank also began to buy and sell securities itself as a mechanism to control the amount of money. Five building societies were founded by business groups: Davivienda, Colpatria, AV Villas, Conavi, Granahorrar, and Ahorramas.

As presented in Table 3, a result of the reforms was that 17 business groups diversified their position into financial services, including commercial banks, investment banks, investment funds, and insurance companies. By becoming shareholders in the financial sector, groups were able to diversify their sources of funding and identify investment opportunities through the board of directors. Moreover, five financial business groups consolidated after 1965.

The capital market was underdeveloped. As Currie (1950, p. 56) observed, 'people who wish to initiate new ventures must rely almost entirely on funds obtained through the retention of profits in their own businesses or through personal contact from friends (…) it is difficult to launch a new venture without direct personal access to capital (…) there is evident need for developing a more open capital market'. Although in the early 1920s the country witnessed a first wave of mergers and acquisitions via secondary equity offerings, the firms' share capital was negotiated among families or regional entrepreneurs without the need for a stock exchange (Álvarez, 2003, p. 225) – a pattern that continued during the second half of the twentieth century.

Table 3. Number of group-affiliated firms, non-financial and financial, 1955, 1965, 1975.

Consolidation decades	No.	Business Group	Non-Financial			Financial		
			1955	1965	1975	1955	1965	1975
Before 1950	1	Grupo Empresarial Antioqueño	13	17	27	3	4	6
	2	Grupo Familia Puyana	7	11	10	1	1	1
	3	Organización Carvajal	1	5	7	1	1	1
	4	Organización Corona	3	10	15	0	3	6
1950–1959	5	Cementos Samper	7	12	15	0	0	0
	6	Familia Gutt Haime	2	6	13	0	1	1
	7	Grupo Mayaguez	2	3	7	1	1	1
	8	Grupo Santo Domingo	6	27	46	1	4	6
	9	Organización Chaid Neme Hermanos	2	7	10	0	0	1
1960–1969	10	Cadenalco	1	9	10	0	3	3
	11	Grupo Fabricato	3	6	9	0	0	0
	12	Grupo Bolivar	0	1	4	3	5	9
	13	Grupo Espinosa	2	4	11	0	0	0
	14	Grupo Grancolombiano	0	1	4	0	6	9
	15	Grupo Gilinski	2	3	4	0	0	0
	16	Grupo Inversiones Mundial	1	2	9	0	1	2
	17	Grupo Sanford	1	5	4	0	0	0
	18	Inversiones Manuelita	1	4	4	0	0	1
	19	Organización Ardila Lulle	4	18	35	0	0	4
1970–1979	20	Grupo Colombina	1	2	4	0	0	0
	21	Grupo Casa Toro	0	0	3	0	0	2
	22	Grupo Colpatria	0	0	0	1	4	6
	23	Grupo Superior	0	1	2	0	0	0
	24	Grupo Inversiones TQ	0	2	4	0	0	1
	25	Organización Sarmiento Angulo	0	0	1	0	0	4
Total group-affiliated firms			**59**	**156**	**258**	**11**	**34**	**64**

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

Only Bogotá had a stock exchange from 1950 to 1961, when Medellín, the second industrial centre, opened another. The stock market was trading a small number of stocks and the value of these were low as a proportion of GDP – less than 3 per cent. The number of companies registered at the stock exchange increased from 85 in 1950 to almost 200 in the mid-1970s, although it was still less than 20 per cent of the active companies in the country (calculated from BanRep (1930–1982)). Concentration amongst a handful of large companies was high. For instance, between 1951 and 1961, Bavaria and Coltejer, both the largest companies of their business groups, accounted for two thirds of all the volume of stocks traded; and out of 17 bond emissions carried out, 13 corresponded to government securities and only 2 were industry issuances. The value of transactions nonetheless rose during the period, from 206.7 million pesos in 1950 to 4,878 million in 1974, mainly due to the creation of the second stock exchange (calculated from BanRep (1930–1982)). However, only a relatively small part of this expansion was for the issuance of new shares; the larger part was for the retention of earnings and the volume of transactions was highly concentrated in 6 firms in 1949, 17 firms in 1964, and 24 in 1978. The limited use of the stock exchange is partly explained by inflationary pressures that put investors off fixed-income securities, and more probably, by the return of economic normality and the preference for real estate investments in expanding cities and in land and farms in the countryside.

Sources and capital structure patterns

The rent-seeking capabilities hypothesis provides a motivation for the different choices firms make in financing their activities. After the reform of the Central Bank in 1951, a few industrialists started to benefit from credit allocation. According to Kalmanovitz and Avella (1998), both industrialists and agrarians (mainly the coffee growers) managed to advance their corporative interests by capturing the rents originating in the seigniorage of the Central Bank. In particular, it is possible that the policies had an effect on the private sector's investment financing and savings, as well as causing changes in ownership concentration. Different forms of finance present varying costs to the firm, affecting returns to investment and possibly the decision to invest at all. Firm capital structure may reveal insights into the costs of finance as well as potential financial constraints faced by individual firms and the economy as a whole.

Moreover, as Baccaro and Pontusson (2016) argue, the varieties of capitalism literature has emphasised institutional differences between countries, but not the dynamic relationship between economic agents and the government or their interaction with the financial system. As the literature on corporate governance claims, the underlying factors for the emergence of complex ownership structures, such as business groups, are related to the ways the individual firms finance their investments. In other words, it is possible that firms use debt instead of equity to finance their investments and consolidate (and later protect) their ownership and control structures, creating strong internal markets.

Overall, group-affiliated firms finance their activities in several ways, ranging from reinvestment to debt. As presented in Table 4, the primary methods of financing were mainly external. Debt funding, particularly credit from domestic banks, was the most important type of capital for the firms. As the use of credit increased in the 1960s, reinvestment decreased. Group-affiliated firms moved from relying on funds from family and friends, the main source of capital between 1920 and 1950, to more use of formal credit through commercial bank loans, upon which the interest rate declined from 1968 to 1974.

The increase in the demand for capital from other financial institutions is explained by the creation of the regional investment banks, which provided access to government funds for the development of the private sector. Owners and senior managers of the business groups were board members of the recently created regional investment funds, while the government provided the funds. As a result, Grupo Santo Domingo participated in Corporación Financiera del Norte, Grupo Empresarial Antioqueño in Corporación Financiera Nacional, Grupo Carvajal in Corporación Financiera del Valle. Three of the largest business groups, located in the main industrial regions, were thus promoting regional investment.

Table 4. Aggregated sources of capital in group-affiliated firms, 1950-1975.

Year	Internal sources	Reinvestment	Depreciation	External sources	Credit	Equity
1950	41.94%	28.39%	13.56%	58.05%	47.92%	10.13%
1955	36.14%	15.26%	20.88%	63.86%	−10.99%	74.85%
1960	44.55%	31.74%	12.81%	55.97%	31.18%	24.27%
1965	33.53%	21.47%	12.06%	66.47%	43.29%	23.18%
1970	28.84%	18.56%	10.28%	71.16%	40.19%	30.97%
1975	32.59%	23.01%	9.58%	67.41%	50.93%	16.48%

Source: Compiled by the author from statements of financial positions, specifically the information related to current assets and liabilities (capital and loans). The total corresponds to the sum of the group-affiliated firms in each year. In the years 1952 and 1958 not all the companies registered are included.

Later in the period when building societies where approved by law, the business groups moved towards investments in construction and the financial sector through the ownership of building societies. The financial groups previously listed increased their market share, creating an oligopoly over which the government had no regulation. Grupo Grancolombiano, Grupo Bolívar, Grupo Empresarial Antioqueño, and Grupo Colpatria owned building societies that promoted housing in the main cities.

Also, there was an increase in the use of equity by more than four times between 1959 and 1965. From the data collected on the total securities by issuer, the importance of group affiliation is notable. The value of the shares issued by corporations steadily increased, while bonds increased by only a small proportion and were mainly the ones issued by law. Therefore, it seems that the issuing of corporate equity was considered perhaps the most effective way to use savings for investment. This increased the cross investment between groups, since the largest listed group-affiliated firms invested in the shares of companies from the other groups, increasing cross-ownership. For example, Organización Ardila Lulle bought 51 per cent of the shares of Coltejer from Grupo Empresarial Antioqueño, to then sell them a percentage of Banco Industrial Antioqueño, redistributing the ownership and market power in two industries: textiles and commercial banking (Table 5).

It is noticeable that business groups derived a large share of their funds from sources external to the firm. As shown in Table 5, for all firms in the sample, external sources provided 73 per cent of total capital (loans provided 41 per cent and equity 32), while internal reinvestment provided just 27 per cent. While the number of group-affiliated firms listed on the stock exchange declined from 54 per cent of the total companies in the groups in 1950 to 28 per cent in 1980, in practical terms all these firms traded actively on a regular basis, becoming the major share traders. However, the share turnover by the end of the period only accounted for 8.5 per cent of the total funding. As a result, there was an increase in ownership concentration compared to 1950. In fact, business group agglomeration increased in the period 1965–1975 across all industries, with a peak in the years 1972–1975, when building societies were created.

Prolonging the partnership experience in mining, colonisation, and trade enterprises, the smallest firms merged, creating large firms per industry. The complexity and size obtained by the companies forced their owners to learn the management and production methods in vogue abroad. Although the textile, food, and beverage industries became the leaders of the Colombian economy, they kept experiencing short cycles of capital scarcity. This produced an important change in the ownership structure: businesses moved from partnerships to companies with limited liability, just to gain access to capital (Figure 3).

As presented in Figure 3, the uses of capital mainly related to the operation of the group-affiliated firms and in second place to investments in fixed capital. A noticeable feature in the use of funds is the high degree of financial investment (including equity investments and loans to other firms). Of these financial investments, more than 60 per cent were in the form of loans to other firms, and less than 10 per cent were equity investments in other firms affiliated with the same group. Looking at the largest 94 manufacturing firms extracted from the total of 428, they show a similar pattern: financial investments accounted for about half of total capital used during the 1960s and 1970s.

To sum up, the financial reforms during the period allowed business group leaders to strengthen their participation in the board of directors of the commercial banks by

Table 5. Sources of capital by business group, 1950–1975.

Business Groups (1)	Holding (2)	No. Firms	Equity (%)	Reinvestment (%)	Loans (%)
Grupo Empresarial Antioqueño	Cementos Argos	13	20.30	34.10	45.60
	Cía. Nacional de Chocolates	6	21.20	46.70	32.10
	Ind. de Alimentos Zenu	4	17.30	34.20	48.50
Grupo Familia Puyana		11	21.40	63.00	15.60
Cementos Samper		15	45.40	13.80	40.80
Organización Carvajal		8	29.40	64.00	6.60
Familia Gutt Haime		14	29.90	24.90	45.20
Grupo Mayaguez		8	36.00	64.00	0.00
Grupo Santo Domingo	Bavaria	23	48.00	29.50	22.50
	Avianca	5	19.40	17.30	63.30
	Colinsa	9	20.50	44.30	35.20
	Flia. Santo Domingo	13	17.30	50.10	32.60
Organización Chaid Neme Hermanos		11	30.50	34.50	35.00
Organización Corona		21	22.80	25.20	52.00
Cadenalco		13	31.70	30.20	38.10
Grupo Fabricato	Fabricato	9	35.20	31.80	33.00
	Tejicóndor	8	20.90	36.20	42.90
Grupo Espinosa		11	33.90	18.60	47.50
Grupo Gilinski		4	23.10	49.50	27.40
Inversiones Manuelita		5	33.10	44.50	22.40
Organización Ardila Lulle	Coltejer	6	15.60	25.70	58.70
	Postobon	20	43.00	36.00	21.00

[1]Only non-financial business groups and group-affiliated firms are presented here.
[2]By 1975 only four of the studied business groups were showing a pyramidal structure, in which the main company in a certain industry was holding the firms within the same industry. The number of business groups moving from Type 1 - Diversified horizontal to Type 2 – Pyramidal kept increasing after 1975.
Source: Compiled by the author from Rodriguez-Satizabal (2020).

increasing their shareholdings and become members of the board of directors of the newly created regional investment banks. Moreover, they became owners and majority shareholders of the building societies. This changed the allocation of credit. Business groups were able to increase their access to loans and captured the capital market, since the transactions on the stock exchanges were only performed by the largest group-affiliated firms.

Internal capital markets growth

The availability of new sources of capital promoted by the government during the period spurred the creation of internal capital markets, which allowed the allocation of capital among group-affiliated firms. Colombian business groups' structure, as in many other countries, is dynamic. Most of the business groups during the period remained as diversified horizontal groups. However, as mentioned before, they all affiliated with investment funds to manage the shareholding and control of the various group-affiliated firms. Moreover, groups reorganised their group-affiliated firms under one company, coordinating the others

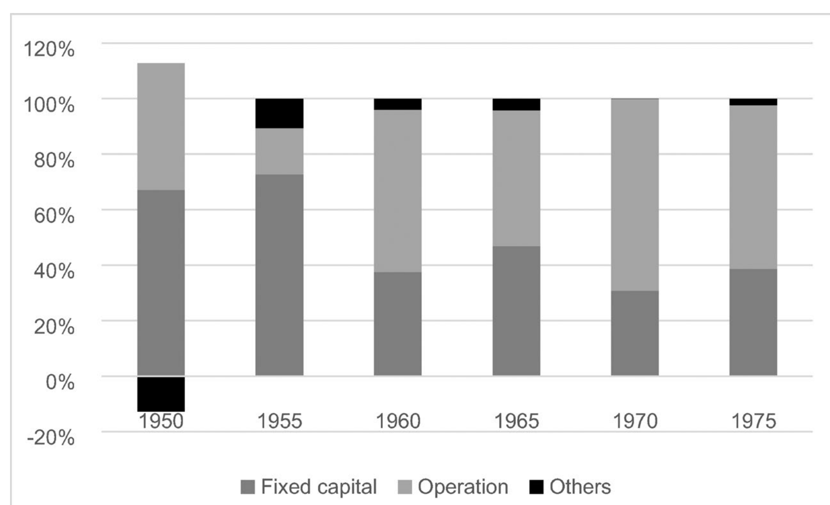

Figure 3. Uses of capital in group-affiliated firms.

through shareholding and directors. Only four non-financial and two financial groups presented the beginning of a pyramidal structure since the late 1960s. Grupo Empresarial Antioqueño, Grupo Santo Domingo, Grupo Fabricato, Organización Ardila Lulle, Grupo Grancolombiano, and Grupo Bolívar reorganised their group-affiliated firms under holdings by sector, thereby facilitating the access to loans and directing reinvestment. As a result, the structure became more hierarchical over the rest and cross shareholding between the largest firms was adopted.

The opening of new opportunities in the financial sector, the absence of intermediaries (as the business groups' leaders were part of the business elite), and the small concentrated capital market encouraged the strengthening of the business groups. Through the internal market, within groups and extended through crossholdings between groups after 1967, groups diversified into unrelated activities, overcoming financial constraints for some of their affiliates by using loans granted to either the core business or to the special purpose entities. However, group-affiliated firms became more dependent on internal sources of capital. Through this internal capital market, firms with the best performance were able to channel cash flow to liquidity-constrained affiliates in the network. Equity and reinvestment accounted on average for more than 61 per cent of the sources of funds between 1967 and 1975.

As a result of business groups' increasing investment in financial institutions, there was a change in the configuration of the board of directors. Business groups' leaders were increasingly members of the boards of the commercial banks, regional investment banks, and building societies. As shown in Table 6, the number of groups with at least one member on the board of directors of a financial institution increased from 7 in 1955 to 18 in 1975. Moreover, interlocking directorates became a common feature after the mid-1960s, when more than 50 per cent of the group-affiliated firms had common board members in both the financial and non-financial sectors. Most of the largest group-affiliated firms had at least two common members on the boards of directors across financial institutions. The fast growth of the ownership network was more evident between 1972 to 1978, when

Table 6. Business groups members of boards of directors of domestic commercial banks, regional investment banks, and building societies, 1950–1980.

	1955	1965	1975
Number of financial institutions	9	12	39
Average board members	5	8	14
Number of groups with at least one member on the board of directors of a financial institution	7	12	18
Group-affiliated firms with common board members	21	98	218
Group-affiliated firms common board members / Total group-affiliated firms (%)	30	51	67

Source: Compiled by the author from the Superintendencia Financiera's archives.

business groups increased cross-shareholding, mainly in traditional industries and banking.

Only in a few cases did business groups keep increasing debt with external sources, mainly in those firms highly indebted before 1965, with need of fixed capital or with losses for more than five years. Cementos Argos, Avianca, Tejicóndor, and Coltejer kept using external loans from commercial banks and the government. In the case of the first two companies, a cement producer and the largest airline, the increase in loans was a result of the buying out of smaller companies in their sector. The last two companies, both in the textile sector, were highly indebted as an attempt to save them from dissolution.

In general, groups in non-financial industries maintained the core business, usually the largest firm in the group, with debt at 22 per cent on average. In the cases of Grupo Santo Domingo (Bavaria), Organización Corona, Inversiones Manuelita, Organización Ardila Lulle (Postobón), Grupo Gillinski, and Familia Puyana the strategy was a way to stabilise the aggregate profits and increase the chances of the group gaining access to other sources of capital. Organización Carvajal and Grupo Mayaguez, both owned by business families from the early industrialisation process, maintained the lowest level of debt. For all cases, the growth of the internal capital market can be seen in the increase of group-affiliated firms from 70 to 428.

The increased affiliation to the group of 'special purpose entities' became a reality after the changes in the Code of Commerce in 1955. Under the legal figure of '*inversiones*' (investment funds), the business groups were able to affiliate companies to maximise the access to loans and avoid adding debt to the largest group-affiliated firm, which was the core business of the group. A total of 35 special purpose entities were affiliated to 16 business groups during the period, mainly between 1965 to 1975, when the number of special purpose entities increased from 18 to 35. In the cases of Grupo Santo Domingo, Organización Ardila Lulle, Grupo Grancolombiano, Cadenalco, and Grupo Inversiones Mundial, the largest group-affiliated firm was never in debt during the period. The special purpose entities of these groups were used to hedge the value of investments in diversified industries, such as building, textiles, food, cleaning products, and chemicals.

Through their internal capital markets, business groups diversified across related and unrelated industries to smoothen out capital flows, thereby capturing the financial institutions and overcoming any other constraints in the environment. The relationship between external sources and business groups became one of trust. For those financial intermediaries outside the business groups' networks, the existence of an internal capital market gave them the guarantee of expected returns. Moreover, it increased the cross-shareholding between business groups.

Final remarks

In the case of Colombia, business groups co-evolved with their institutional settings and national policies. The dominant business elite created before 1950 used the groups' organisational structure to capture both new financial intermediaries and capital markets. Although in this study only the changes in the financial legislation were considered, group-affiliated firms presented a pattern of sources and uses of capital that helped to develop stronger internal capital markets and, as a result, a highly diversified, strong organisational structure. It is commonly understood that internal capital markets played a significant role under market imperfections (Khanna & Yafeh, 2007). As this article shows, massive investments and new entries in alternative industries were supported by internal capital markets, which became stronger whilst the organisational structure was growing. More often, business groups invested their high profits from the core business (a cash sector) into growth sectors, following changes in the financial sector. Once the firms started to go public or increase their access to new credit, the internal capital markets started to play a role in reallocating funds that had been raised externally.

The policies promoted by the World Bank mission shaped the strategy of the business groups after their implementation. In practice, both reforms resulted in opportunities for business groups to enter the banking sector and consolidate their domestic position. The government acted, first, as a rule-maker to later increase the close links between the state and the business, through the formal membership of business group owners in the board of directors of the newly created financial institutions. Moreover, business groups changed their portfolio strategies by increasing their investments in banks and regional investment funds. As a result, groups looked to rapidly increase their domestic market shares and, even, buy shares from other groups across the country.

The business system was thus dominated by business groups with enough market power to diversify into every sector with credit available. The government settled into its role as rule-maker issuing laws that benefitted the largest companies, which grew faster from 1965 to 1974. Groups continued being the dominant actor in the Colombian economy and the government kept promoting the central role of entrepreneurs in the economic development of this so-called emerging country. The Colombian business groups had a growth pattern very similar to the Chilean and Mexican cases. The barrier to entry was mainly the restrictions on access to capital, the business networks grew during the ISI period, and there was a close relationship between non-financial and financial firms. However, in contrast to the Mexican case, only a few groups fully controlled a commercial bank.

The consolidation of business groups, followed by their investments in the financial institutions created by the new legislation in Colombia, are an example of how the interaction between institutions and organisations results in solutions for the expansion of the firm. Business groups allow flexibility to react to the changes in the financial legislation and to increase the firms' access to capital, creating a hierarchical capitalism, which is now seen as a characteristic of Latin America's business and economic development.

Notes

1. Business groups typically consist of a set of legally independent firms, operating in multiple (often unrelated) industries, which are bound together by persistent formal (for example,

equity) and informal (for example, family) ties. They are neither bound merely by short term strategic alliances nor legally consolidated into a single entity, but are owned, and often controlled, by the same owner(s) (whether individual, family, or regional entrepreneurs).

2. Superintendencia de Sociedades is the government agency responsible for inspecting and overseeing large public limited companies since 1931.
3. The number of companies refers to those registered as active in the Superintendencia de Sociedades.
4. This terminology is taken from the literature on the Enron case; it refers to limited partnerships or companies created to fulfill a temporary or specific purpose to fund or manage risks associated with specific assets.

Disclosure statement

No potential conflict of interest was reported by the author(s). This paper is based on Chapter 4 of the author's doctoral thesis at the School of Business and Management at Queen Mary University of London.

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