BETTER TOGETHER: NETWORK STRATEGIES DURING ECONOMIC AND POLITICAL TRANSITIONS –EVIDENCE FROM CHILE

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Abstract
To study the persistence of network strategies and their associated governance structures during a transition in the institutional environment from a limited political and economic system to a more open one, we analyze the network strategies of domestic business groups, multinational corporations, and state-owned enterprises in Chile, relative to the wider historical context of institutional transitions in that nation between 1970 and 2010. We argue that (a) the effects of transitions at the institutional environment level are historically determined and therefore their understanding requires historically informed methodologies and analyses; (b) a transition from a more limited to a more open economic and political environment does not necessarily eliminate market imperfections, but it could change the nature of these imperfections from transactional to structural; and (c) open political and economic systems do not decrease incentives for network strategies, such as building interlocked corporate board networks and related governance structures. Rather, they create new incentives to continue using such pre-transition strategies and structures.

Keywords: Institutional Transitions, Network Strategies, Business Groups, State-Owned Enterprises, Multinational Corporations, Telecommunications
INTRODUCTION

Studies of corporate strategy and governance maintain that the more political and economic restrictions that exist in an institutional environment, the greater the incentives organizations have to develop network strategies, and the governance structures associated with them, as opposed to strategies based on price mechanisms (Ahuja & Yayavaram, 2011; Henisz & Zelner, 2004; Moszoro & Spiller, 2012; North, Wallis, & Weingast, 2009; Spiller, 2008). Addressing the potential restrictions in a specific political and economic environment, or institutional environment (Davis & North, 1971), is particularly important in the many contexts that have undergone dramatic transitions in the past three decades. The nature of these transitions has mitigated existing economic and political restrictions, thus affecting organizations’ strategy and governance structures. Starting in the late 1980s and early 1990s for example, a vast number of nation-states abandoned their protectionist and interventionist economic systems in favor of more open, globally oriented markets, in conjunction with replacements of military or authoritarian regimes by more democratic ones (Huntington, 1991; Jones, 2005). As the transitions began, some scholars predicted a global convergence toward a Western model of liberal democracy and market economics (Fukuyama, 1992), which would give firms incentives to compete on the basis of market strategies (e. g. price and quality) and decrease incentives to compete through the creation of networks between firms or firms and other actors such as individuals close to the government.

However, the process that eventually took place did not match this description. First, countries that underwent the transitions did not blindly copy the Western model but rather created new varieties of capitalism (Hall & Soskice, 2001) and democracy (Bochsler & Kriesi, 2013). Second, despite shifts toward more open political and economic systems, firms continued using their network strategies, developed in the pre-transition period, and maintained or reinforced the associated
governance structures (Colpan & Hikino, 2010; Feenstra, Huang, & Hamilton, 2003; Kandel, et al., 2013; Langlois, 2010; Manikandan & Ramachandran, 2014; Markides, 2002). To address this divergence, we study network strategies consisting of creating interlocking directorates among organizations developed by domestic business groups, multinational corporations (MNCs), and state owned enterprises (SOEs) in an emerging economy that has undergone stark political and economic transitions. To detail these strategies, we combine historical research and quantitative network analysis with conceptual frameworks and debates from literature pertaining to market imperfections, institutional voids, and historical institutionalism. Ultimately, we argue:

(a) The effects of transitions at political and economic levels (or the institutional environment level) are historically determined and require historically informed methodologies and analyses.

(b) A transition from a more limited to a more open economic and political environment does not necessarily eliminate market imperfections; rather, the nature of these imperfections may change, from transactional to structural.

(c) Open political and economic systems do not decrease firms’ incentives to engage in network strategies and their related governance structures; rather, they create different incentives to continue using the existing network strategies and structures.

In the next section, we discuss the importance of historical analyses of the operations of firms in a global context. Then we propose our conceptual framework of transactional and structural market imperfections, leading in to the theoretical framework we use to analyze political and economic transitions. After we explain our methodology, we analyze the network strategies of various actors in Chile’s political and economic transitions. Finally, we discuss our findings, their implications, and our conclusions.
HISTORICAL DETERMINISM AND STRATEGY IN THE GLOBAL ECONOMY

Scholars calling for a return to historically informed research note particular concerns about the way the political context gets analyzed. Cantwell et al. (2010) worry that scholars analyze the wider institutional environment as fixed and exogenous, an assumption made explicit by some academics (e.g., Behrman & Grosse, 1992; Buckley, 1993; Eden, Lenway, & Schuler, 2005; Grosse, 2005; Murtha & Lenway, 1994; Williamson, 1996), though more often implicitly present in the studies’ constructions. The assumption even has permeated studies using neo-institutional approaches. Although early studies were explicitly historical (Gouldner, 1956; Selznick, 1957), a gradual acceptance of rational choice and purely quantitative methods as the “only” acceptable approaches led scholars to neglect the history of institutional environments and organizations, despite the effects on the way those entities interact (Bucheli & Kim, 2014; Suddaby et al., 2014). The methodological outcomes mean that the institutional environment must be more than mere background information though, because it is an integral part of the phenomenon of inquiry (Gaddis, 2002; Yates, 2014). The relationship between the institutional environment and its organizations also requires an analysis of the processes that precede the focal issue being studied (Berger & Luckman, 1967).

Different calls by international business and strategy scholars recommend analyzing the actions of particular organizations in their historical framework, instead of relying solely on large databases (Cantwell, Dunning, & Lundan, 2010; Jones & Khanna, 2006). In addition to business and economic history (Jones, 2005; Musacchio & Lazzarini, 2014; North et al., 2009), the current study thus integrates intellectual traditions from political science (Acemoglu & Robinson, 2006; Linz & Stepan, 1996), sociology (Granovetter, 2005; Mizruchi & Marquis, 2006), organization studies (Colpan & Hikino, 2010; Leff, 1978), and neo-institutional economics (Davis & North, 1971), consistent with calls for more interdisciplinary research (Cantwell & Brannen, 2011; Nickerson &
Bigelow, 2008). Such calls reflect a wider concern about the gradual abandonment of historically informed research in management and organization studies (Üsdiken & Kipping, 2014) and the negative effects of this absence for the disciplines (Kahl, Silverman, & Cusumano, 2012; Kieser, 1994; Suddaby, Foster, & Mills, 2014; Wadhwani & Bucheli, 2014; Zald, 1990). By responding to these calls, we confirm the importance of research that not only is informed by historical methods but also considers the historical context as integral to the problem being analyzed, not just “background” information for unfamiliar readers (Carmeli & Markman, 2011). The current study does not use history as a field to test a theory but rather aims to contribute to existing efforts to make history integral to analyses and thereby build theory in management and organization studies (Kipping & Üsdiken, 2014). With this goal in mind, we use the historically determined institutional environment and organizational strategies and structures as our departure point, from which we seek to advance a theoretical framework that explains the survival of network strategies and associated governance structures, even after a process of transition at the institutional environment level.

TRANSACTIONAL AND STRUCTURAL MARKET IMPERFECTIONS

Studies of the operations of MNCs, business groups, and SOEs often acknowledge that markets are not perfect and that the presence of governments, political interests, uncertainty, and opportunism, among other issues, explain the raison d’être and persistence of these organizational forms. Khanna and Palepu (1997, 2000) identify how such market imperfections disrupt the smooth connection between buyers and sellers. Classic international business studies that sought to explain the existence of MNCs noted that they could not exist in perfect markets, in which price adjustments led to supply and demand equilibriums (Dunning, 1971, 1988, 2009; Kindleberger, 1969). Rather, MNCs exist because the world is imperfect, and trade barriers and information limits require firms to develop such international operations. Then applications of transaction costs economics theory tried
to explain MNCs’ long-term expansion (Buckley & Casson, 1976; Hennart, 1982). The recognition of the less-than-perfect international political environment for MNCs, marked by various uncertainties and different types of governments, also led to the development of bargaining power theory to explain why some governments countered MNCs’ property rights (Vernon, 1971; Wells & Smith, 1975).

Scholars studying business groups also cite market imperfections to explain their existence, defining any such group as a “multi-company firm which transacts in different markets … under a common and administrative control [in which] participants are linked by relations of interpersonal trust, on the basis of similar personal, ethnic, or commercial background” (Leff, 1978: 663), or else as “loose coalitions of firms which have no legal status and in which no single firm or individual holds controlling interests in other firms” (Granovetter, 1995: 96). More detailed studies of business groups in different countries have produced a wider variety of definitions, and recent scholars often opt for a more comprehensive view of the “clusters of coordinated activities carried out by interlinked but legally independent enterprises” (Colpan, Hikino, & Lincoln, 2010: 6). The general structure can be based on an alliance principle, implying network-type business groups, or an authority principle, with hierarchical groups that tend to be diversified or take a pyramidal structure (Colpan & Hikino, 2010). According to various studies (Carney, Gedajlovic, Heugens, Van Essen, & Van Oosterhout, 2011; Guillén, 2000; Khanna & Palepu, 1997, 2000; Leff, 1978), business groups were created to overcome institutional voids, such as inefficient labor or financial markets, corrupt or underdeveloped governments or judicial systems, or opaque political systems. Manikandan and Ramachandran (2014) argue further that portfolio diversity, unique to business groups, enables them to access opportunities hidden by incomplete strategic factor markets. Business groups thus developed differently than traditional, multidivisional enterprises (Colpan & Hikino, 2010; Granovetter, 2005), with their own
brand of network capabilities, including formal and informal relations with the state (Guillén, 2010; Schneider, 2004).

Finally, scholars studying SOEs propose that they exist to overcome market imperfections (Cardoso & Faletto, 1979), to generate rents for those in political power, or because societies inherited them from previous more restricted political and economic systems (Musacchio & Lazzarini, 2014). These various explanations all assume that market or political imperfections provide the impetus for the creation of SOEs.

To overcome their market imperfections, MNCs, business groups, and SOEs all can choose to compete through network strategies, one of them being building networks with government officials and other firms through corporate board interlocks (Boddewyn & Brewer, 1994; Etzion & Davis, 2008; Henisz & Zelner, 2004; Hillman, Keim, & Schuler, 2004; Hillman & Wan, 2005; Salvaj & Couyoumdjian, 2015; Zheng, Singh, & Mitchell, 2014). This type of network strategy clearly can help fill existing institutional voids due to market imperfections, but to explain the persistence of this strategy and its associated governance forms even after a transition into a more open institutional environment, we consider two further types of market imperfections (Dunning & Rugman, 1985): transactional and structural.

Transactional market imperfections can result from opportunism, bounded rationality, uncertainty, and asset specificity (Buckley & Casson, 1976; Coase, 1937; Hennart, 1982; Williamson, 1985). They are not created by the firms themselves, but rather provide the raison d’être for the firm; non-trivial transaction costs create incentives for firms to internalize their market transactions, to mitigate those costs. Structural market imperfections are those sought by firms that want to enjoy monopolistic benefits. This perspective has its intellectual roots in industrial organization (Hymer, 1960/1976), such that “a firm’s performance in the marketplace depends critically on the
characteristics of the industry environment in which it competes” (Porter, 1981: 610). Some structural characteristics of particular industries—such as barriers to entry (Bain, 1956), the number and size distribution of firms (Bain, 1968), and barriers to mobility (Caves & Porter, 1977)—are crucial to ensuring a firm’s performance. Therefore, firms seek to create the imperfections, to obtain and maintain their competitive advantage over other firms.

Literature on institutional voids often adopts a rationale similar to that followed by transaction costs economics scholars: The best way for an organization to overcome the friction created by institutional voids is to internalize otherwise external markets (Buckley & Casson, 1976). Network strategies offer an alternative to vertical and horizontal integration, with the same objective of mitigating market frictions by joining a relevant network, which enables the firm to learn, build trust, develop commitment, and identify opportunities (Johanson & Vahlne, 2009). For the case of the MNCs, Cantwell et al. (2010) define relational capabilities as an ownership advantage, because they permit the MNCs to create distinct networks in various situations. Furthermore, even if not explicitly, other scholars account for structural market imperfections when analyzing network strategies, identifying them as ways to create political coalitions against anti-market forces such as labor unions (Schneider, 2004) or block the entry of competitors (O’Donnell, 1982). Following this logic, less pluralist regimes might create more incentives for network strategies than pluralistic ones (Henisz & Zelner, 2004; Hillman et al., 2004). In turn, we apply these market imperfection dimensions to understand why some network strategies and governance structures survive transitions from more limited to more open institutional environments.

**SOCIAL ORDERS AND TRANSITIONS**

To analyze the historical evolution of the institutional environment and its relationship with the historical evolution of organizations, we borrow a conceptual framework from political science
and economic history. Davis and North (1971: 6) define the institutional environment as the “set of fundamental political, social, and legal ground rules that establishes the basis of production, exchange and distribution.” An incomplete institutional environment lacks a rule of law, constraints on organized violence, and third-party enforcement of contracts (Campbell & Lindberg, 1990; Scott, 2008). Davis and North (1971: 7) further define institutional arrangements “between economic units that govern the ways under which these units cooperate and compete.” Such arrangements might feature organizations and other actors, such as the state, consistent with the wider rules of the game defined by the institutional environment (Leftwich, 2006). Developments at the institutional arrangements level thus cannot be understood in isolation from what happens at the institutional environment level.

North et al. (2009) refer to the social order as general patterns of social organizations resulting from interactions of the institutional environment and institutional arrangements. They identify two types of social orders: (a) limited access orders and (b) open access orders. In the former, a select group creates a dominant coalition to limit or control access to economic rents. Economic competition is mainly political in nature while the latter invokes competition conducted through price and quality mechanisms (Holburn & Vanden Bergh, 2014).

In addition, the final outcomes of struggles for political power determine the type of institutions or social order in a particular society (Acemoglu & Robinson, 2006). The type of political institutions characterize the formal distribution of political power (de jure); the distribution of economic resources and the ability of any particular group to defend its economic interests instead determine who can impose their wishes on society (de facto). Democracy implies a political institution in which “collective decision makers are selected through fair, honest, and periodic elections in which candidates freely compete for votes and in which virtually all the adult population
is eligible to vote … [and] the existence of those civil and political freedoms to speak, publish, assemble, and organize that are necessary to political debate and the conduct of electoral campaigns” (Huntington, 1991: 7). Acemoglu & Robinson (2006: 24) add that a political institution with these characteristics must be “durable” to be classified as “democracy.” Across the wide variety of democratic regimes, depending on the distribution of economic resources, some provide de facto power to a larger segment of the population than others (Acemoglu & Robinson, 2006). In North et al.’s (2009) terms, a democracy meets the criteria for an open access social order. In contrast, a dictatorship is a regime in which “an elite, a junta, an oligarchy, or just one person … is making the [political] decisions” (Acemoglu & Robinson, 2006: 18). There are many forms of dictatorship. Linz and Stepan (1996) posit that the most relevant modern-day definitions involve totalitarian and authoritarian regimes. In the former, a political institution ruled by one party has eliminated any previously existing pluralist system, maintains an official guiding ideology, and mandates obligatory participation in mass popular organizations. The latter instead has its roots in a previously existing system, has some space for weak semi-opposition, lacks a set ideology (but expresses a clear, distinctive mentality), and does not feature mass political mobilization. Again using North et al.’s (2009) terminology, they represent limited social orders.

Authoritarian and totalitarian regimes can become democracies through a transition. As Linz & Stepan (1996: 3) define it, a transition to a democratic regime occurs when sufficient agreement has been reached about political procedures to produce an elected government, when a government comes to power that is the direct result of a free and popular vote, when this government de facto has the authority to generate new policies, and when the executive, legislative, and judicial power generated by the new democracy does not share power with other powers de jure. Acemoglu and Robinson (2006) argue that this transition can have various roots, and Huntington (1991) cites the
importance of global changes, such as democratization trends and economic crises. For Linz and Stepan (1996) previous political institutions determine the transition processes, so arrangements that allow for a transition to a democracy depend on the historically determined social and political characteristics of the country. For example, if moderate opposition exists during the authoritarian regime, the transition can result from a pact between the dictator and members of the country’s upper echelon. We consider such transitions in our analysis.

A totalitarian or authoritarian regime is not necessarily unstable, unconsolidated, or lacking in legitimacy for many citizens. The People’s Republic of China exemplifies a stable, totalitarian regime; the possibilities of it transitioning to democracy are slim. Former Soviet bloc countries have transitioned to market-friendly economies, but efforts to fully democratize them have failed, in some cases catastrophically (e.g., Aleksander Lukashenko’s regime in Belarus). Regardless of their stability or even their popularity, a neo-institutional view regards authoritarian and totalitarian regimes as incomplete (North & Weingast, 1989), in the sense that they do not generate the conditions necessary for economic competition, sustained economic growth, or individual freedoms. Accordingly, they should provide economic actors with incentives to compete using network strategies, rather than strategies based on competition in price and quality (Khanna & Palepu, 1997; North et al., 2009). It follows logically that a transition from totalitarian or authoritarian regimes to democracy should decrease incentives for network strategies. Yet the transition might not eliminate all voids but rather trigger the creation of new ones.

**METHODOLOGY AND DATA**

We analyze the network strategies of domestic business groups, MNCs, and SOEs in Chile with respect to their relationship with the evolution of the wider historical context of institutional transitions. The historical context is an element that constantly interacts with the actors we analyze
and shapes their decisions (Suddaby et al., 2014). Following Cantwell et al. (2010), we conduct a simultaneous analysis of the institutional environment and its co-evolution with the organizational strategies of three actors. Thus we follow Gaddis’s (2002) recommendation to analyze an actor’s decisions in the context of its relationship with the events that take place both before and after the event in question.

Several characteristics of Chile establish a quasi-experimental setting to investigate the role of institutional change. Currently one of the most successful countries in Latin America, in terms of economic performance and political stability (Larroulet, 2013), Chile has been Latin America’s largest recipient of foreign direct investment for several years (ECLAC, 2011) and is home to powerful and dynamic business groups (Guillén, 2000; Khanna & Ghemawat, 1998). Using North’s et al. (2009) theoretical framework, Navia (2013) argues that between 1973 and 2009 Chile offered an almost perfect example of a country that transitioned from a limited access social order to one of open access.

A historical network analysis explicates how individuals or firms are embedded within relational networks and how these relations hold the larger structure together (Ventresca & Mohr, 2002). Following Cantwell et al. (2010), we analyze the environment in relation to the strategies developed by particular organizations. Therefore, our analysis occurs at two levels: On the first level, we analyze general network strategy trends in the Chilean economy by noting how business groups relate to one another. We analyze their interlocking activities by studying the composition of the boards of directors in 1970, 1978, 1988, 1999, and 2010, which represent benchmarks associated with Chile’s political and economic transitions. We use DeNooy, Mrvar, and Batageli’s (2006) methodology to analyze the evolution of business groups’ network strategies (our first level of analysis), on three dimensions. First, we study their network structures by noting the number and
The percentage of marginal business groups, with just one link; the number of isolated groups with no ties to other business groups; and the number and percentage of business groups belonging to the network’s main component, such that they constitute a maximally connected subnetwork. Second, we study the ties between groups by determining the number of multiple ties between them and the density of the network, as a proportion of the potential maximum number of ties, which we measure for the whole network. Third, we study the distribution of different individual members of interlocked directorates and thus determine the number and percentages of most active directors that sit on two or more business group’s boards in the network, as well as the number and percentages of “big linkers,” or directors on three or more business groups.

On the second level of analysis, at the telecommunications industry level, we conduct an ego network analysis to study the evolution of the network strategies of the three actors (business groups, MNCs, SOEs) during institutional environment transitions. Similar to our analysis of the business groups, we follow DeNooy et al.’s (2006) network methodology to study interlocking directorates of business groups, MNCs, and SOEs in the Chilean telecommunications sector. We calculate their degree and betweenness centrality to illustrate the importance of creating links with other organizations for each type of actor. We also identify the comptroller for each case, the number of directors sitting on boards, the percentage of multiple directors (belonging to more than one board in the network), the number of firms linked through interlocked directorates, the number of firms with which telecommunications firms shared more than one director, and the number of industries linked to the telecommunications industry through interlocked boards. We use the UCINET software packages to generate the quantitative analysis and Gephi software for the graphical illustrations.

Our analysis uses a unique dataset that could only be created by conducting detailed archival research in different institutions for a period covering several decades. The greatest majority of our
information is not available in electronic formats or on the web. For our analysis of business groups we collected the information of all their affiliated companies for our benchmark years of 1970, 1988, 1999, and 2010 using the studies of Hachette & Lüders (2003), Garretón & Cisternas (1970), and El libro de las 91 (1972). The latter two were published during the Allende administration and aimed to illustrate existing income inequalities in Chile. With this information we proceeded to study the board composition of each one of the companies belonging to each group for each of our benchmark years using their corporate annual reports deposited in the Superintendencia de Bancos e Instituciones Financieras (SBIF, Chile’s financial regulator), the Superintendencia de Valores (SVS, Chile’s equivalent to US’ SEC), the Superintendencia de Administradoras de Fondos y Pensiones (SAFPs, Chile’s regulator for pension funds), and Santiago’s Stock Exchange. Additionally, we researched the activities of each one of the individuals in these boards by consulting financial yearbooks, the firms’ annual reports, and bibliographical dictionaries. Our final sample includes 114 firms for 1970, 66 for 1988, 272, for 1999, and 474 for 2010. We have a number of individual board directors of 353 in 1970, 259 in 1988, 1,018 in 1999, and 1,548 in 2010. The business groups include those owned by domestic shareholders, by MNCs, and by the state. According to Colpan and Hikino (2010) and Lefort (2010), the definition that SVS uses is consistent with existing scholarship, so its classification was sufficient for our purposes.

Our analysis of the relationship between the Chilean telecommunications sector with the rest of the economy required similar archival-based research. We created a database of Chile’s largest firms measured in sales with a total of 165 firms for 1969, 151 for 1978, 185 for 1988, 244 for 1999, and 250 for 2005. We created our 1969 sample using the ranking published in El libro de las 91 (1972) and triangulated that information with the highest value corporations in terms of trade conducted at the Santiago Stock Exchange and found strong consistency between both samples. We
found information on board composition for sixty-three out of the ninety-one firms included in *El libro de las 91*. We also include information from investigative media articles published in the weekly magazine *Vistazo* (Anonymous, 1963) during the Christian Democratic rule that preceded Salvador Allende. For 1978, we used as proxy the ranking calculated by Behren-Fuchs (1985) for 1977. For 1988, 1999, and 2005 we used the unpublished ranking calculated by Chile’s internal revenue service. Additionally, we gathered the board information for each one of these firms and conducted detailed biographical research for each one of the directors of the telecommunications firms for the whole period for ninety-one firms stored at the SVS as well as biographical dictionaries, newspaper articles, and a large number of secondary sources.

We read and analyzed all our historical sources within the contextual framework in which they were written and triangulating the information when necessary as suggested by Yates (2014), Kipping, et al. (2014), and Lipartito (2014) in order to have understand the interrelation between these firms and the changing context.

**INSTITUTIONAL TRANSITIONS, NETWORKS, AND ORGANIZATIONAL STRUCTURES IN CHILE**

Our integrative analysis approach considers transitions at the institutional environment level and the simultaneous evolution of corporate network strategies for all the business groups in Chile (or their institutional arrangements). It also incorporates the network strategies followed by business groups and their affiliated firms, MNCs, and SOEs in the Chilean telecommunications sector between 1970 and 2010. These three actors have continued to grow increasingly significant in the global economy, particularly since the early 1990s. The changes in the post-1990 world economy attracted MNCs from traditional capital exporting countries, such as the United States, United Kingdom, and Japan; new MNCs from non-traditional capital exporting countries have played increasingly
important roles, including firms originating in India, China, Brazil, and—of particular interest to our study—Spain (Campa & Guillén, 1998). These latter firms did not copy the strategies previously developed by the former MNCs but rather developed their own approaches, based on their experience in their home countries and the peculiarities of developing and emerging economies, such that they effectively rewrote some of the rules of the international business game (Ramamurti, 2012). Business groups from emerging markets also have become major players, with some developing into MNCs or competing with established Western corporations (Guillén, 2000; Khanna & Ghemawat, 1998).

Similarly, emerging economies’ SOEs transitioned from mere branches of ministries into firms that compete globally and invest in their home countries and in other markets (Cuervo-Cazurra, Inkpen, Musacchio, & Ramaswamy, 2014; Musacchio & Lazzarini, 2014).

**Chile under a Protectionist Democratic System**

Between 1932 and 1973, Chile constituted an anomaly in terms of political and economic stability for world standards: it was ruled uninterruptedly by democratically elected presidents and with the same political constitution, it did not fight any foreign or domestic wars, and its elite largely agreed on basic economic policy terms (Meller, 1990). The economy was based on mining exports developed by MNCs, whose taxation provided capital for a protectionist import substitution industrialization program and basic welfare spending. These decades were marked by state-led industrialization, rapid urbanization, growth of the urban middle and working classes, and the rise of political parties representing these constituencies (Mamalakis, 1976). Yet in 1973, the state represented 39% of Chile’s gross domestic product (GDP) (Chumacero, et al., 2007).

An early import substitution industrialization model created incentives for the private sector to organize around business associations and in business groups. This economic model was carried out through the Corporación de Fomento (CORFO), a state agency in charge of industrial policy
planning and targeting industries favored by the government, as well as channeling government funds and subsidies to the industrial private sector and SOEs (Bucheli, 2010; Silva, 1996). Since its creation in 1938, CORFO operated in close coordination with the private sector, so influential business leaders have held high-ranking positions in CORFO and the ministries in charge of the industries with which they are affiliated. As Schneider (2004: 155) succinctly explains, “after 1939, most of the crucial economic decisions in Chile were made, not by the Senate, but by CORFO in closed-door meetings.” Chile also witnessed the rise of an increasingly militant and organized labor movement that formed the left wing and center parties’ main constituency, prompting an increasingly union-friendly legislature. By the 1950s, Chile’s highly protected and regulated economy relied on differentiated trade barriers, import prohibitions, subsidized credit through bank interest rates, and multiple exchange rates (Silva, 1996). Table 1 illustrates the increasing importance of manufacturing industry in the Chilean economy during that period.

[INSERT TABLE 1 AROUND HERE]

Government control of the economy and the hostility of labor organizations and political parties generated incentives for corporations to organize politically around business associations and economically in business groups. By 1960, 50% of agricultural land belonged to one group, four groups controlled 62% of the insurance sector, the three largest groups controlled 70.6% of all capital invested in Chilean chartered firms, and 100 companies had at least one member of Congress on their boards (Lagos, 1960). During the protectionist/democratic period, we determined that all business groups were part of a main network component; there were no isolated business groups and just two marginal groups. The cohesiveness among the business groups was achieved thanks to 65 multiple directors or directors who were part of more than one business groups (See year 1970 in Table 2). This finding is consistent with Zeitlin, Ewen, and Radcliff’s (1974) analysis of wealth concentration.
in Chile before the 1973 coup. The state-owned business group was the most central actor in the network, a role consistent with the economic model carry out by the government (see Figure 1).

The telecommunications industry was at the center of Chile’s economic policy, starting in 1927, when the government awarded a concession to the U.S. MNC International Telephone and Telegraph, known domestically as Compañía de Teléfonos de Chile (ITT-CTC). In the following decades, processes of urbanization, industrialization, and enlargement of the middle class dramatically increased demand for telephone services. Complaints about ITT-CTC’s subpar service and high rates led politicians to criticize the multinational’s power though, and the center and left-wing parties objected to its political board composition, which mainly represented Chile’s political right. Criticisms increased after a 1960 earthquake revealed serious weaknesses in ITT-CTC’s capability to maintain the country’s lines of communication. Thus, the government founded the SOE Empresa Nacional de Telecomunicaciones (ENTEL) in 1964 to serve isolated areas not covered by ITT-CTC, though this initiative did not end calls to expropriate the MNC (Bucheli & Salvaj, 2013).

As Table 3 indicates, the MNC’s network, through interlocked directorates that connected it to 22 firms in 1999, established it as one of the most centrally connected firms in Chile: It has more than one director connected to the SOE Empresa Nacional de Energia and the powerful private firm Cementos Bío Bío. This high interconnectivity shows that ITT-CTC followed the general trends of Chile’s corporate sector, consistent with theoretical predictions (i.e., a system with more market limitations should generate more incentives for network strategies; Ahuja & Yayavaram, 2011; Henisz & Zelner, 2004; Moszoro & Spiller, 2014). Yet this result did not repeat in subsequent periods.
Rather, political consensus regarding import substitution industrialization started to fracture in the early 1960s. Blaming the model for generating inflation and income inequalities, politicians on the right advocated economic liberalization, whereas those in the center and on the left called for increased control over business groups (Corvalán, 2002). As the polarizing debate grew, business groups organized themselves to defend the status quo and the benefits they had gained (Silva, 1996). What started as a strategy to overcome a series of regulations gradually became a source of oligopolistic power that the Chilean elite strove to protect.

In 1970, the Marxist candidate of a left-wing coalition, Salvador Allende, won the presidential elections. Allende advanced a new agenda that included the expropriation of private property. During his first 17 months in office, the government increased its share in industrial sales from 25% to almost 40%. By 1973, the state controlled 43% of arable land and 100% of what were previously mostly foreign-owned mining operations (Larroulet, 1984). During the Allende administration, ITT-CTC was at the center of a political debate. In 1972, leaked documents showed that it had conspired with the CIA to overthrow Allende. The government responded by taking over the firm’s assets and turning it into a SOE (United States Senate, 1975).

**Chile under an Authoritarian Open Market System**

Allende faced fierce opposition from the Chilean elites, sectors of the armed forces, MNCs, the U.S. government, and contesting political parties. The polarization of Chilean politics during his administration culminated violently on September 11, 1973, when a group of military officers led by General Augusto Pinochet staged a coup, during which the president died. The new ruling junta nullified the constitution and political parties, inaugurating a military regime that lasted 17 years. The members of the military junta officially shared power, but Pinochet gradually assumed more power
and eventually became the sole head of state (Valdivia, 2003). The resulting political system fits Linz and Stepan’s (1996) authoritarian regime category.

Chile’s transition from democracy to authoritarianism paralleled an equally dramatic economic transition. Between 1975 and 1982, Pinochet led one of the world’s most comprehensive privatization programs, strictly adhering to a neoliberal recipe proposed by young Chilean economists known as the “Chicago Boys” (Corvalán, 2002). In 1973, the state owned or managed 593 enterprises whose value added represented 39% of the GDP; by 1983, the number had fallen to 43 enterprises, whose value added represented just 16% of Chile’s GDP (Lüders, 1993). In addition, Pinochet’s economic reforms eliminated wealth and profit taxes, decreased corporate income taxes, and replaced a previously complex tax system with a flat 20% sales tax; tariffs were reduced, and all previously existing import restrictions other than tariffs were eliminated and replaced by a 10% flat tax—a drastic reduction from the previous average of 94%. In 1980, Chile became the first country to privatize social security. The financial sector experienced liberalized interest rates and the elimination of many restrictions. Finally, macroeconomic policy was strictly reoriented to control inflation, which the Chicago Boys asserted generated uncertainties for both consumers and investors (Ffrench-Davis, 2004). Thus, Pinochet’s economic reforms sought to neutralize as many obstacles as possible to the market’s smooth operations.

Yet these economic reforms did not lead business groups to abandon their structures or their network strategies. On the contrary, by 1977, two business groups controlled 37% of the assets of Chile’s 250 largest companies and 40% of private-sector banking (Dahse, 1979). The trend continued, though with different characteristics, after a series of political and economic events in the early 1980s (Gálvez & Tybout, 1985). That is, after aggressively opening the economy, Chile plunged into a deep financial crisis, accompanied by vast social unrest. Despite strict restrictions on political activity,
people from the shantytowns protested en masse in the streets and violently clashed with police; the economic elite grumbled about the regime’s apparent incapacity to stop the chain of bankruptcies and hinted at joining the opposition if orthodox neoliberal policies continued (Schneider, 2004). The crisis was harsh, causing some business groups such as the powerful Vial-BHC to disappear completely, while others, including Cruzat-Larrain, shrank significantly (de la Cuadra & Valdés, 1992). For the first time since the coup, Pinochet’s political coalition was at risk of collapse. Despite the regime’s pro-market ideology, Pinochet pragmatically fired some Chicago Boys, bailed out some financial institutions, and developed relatively heterodox macroeconomic measures (Silva, 1993).

The authoritarian government’s success at overcoming the 1982–1983 economic and political crisis marked the beginning of a new relationship with business groups (Lefort, 2010). First, business groups accepted the new economic model as irreversible and therefore oriented their economic activities toward foreign markets (Ffrench-Davis, 2002). Second, they benefitted from the privatization programs, which provided them with the opportunity to buy previously government-owned assets (Silva, 1996). Third, the government acknowledged the need for a regulatory framework, which materialized in 1986 as legislation that made the business groups’ governance structure official and explicitly defined by the government; thus, the groups’ involvement in financial activities was limited to avoid an uncontrolled spread of economic crises to the wider economy (Lefort, 2010).

After the end of the crisis, a new wave of privatizations of SOEs—in the utilities sector in particular—began to benefit existing business groups by providing them with more available assets and leading to the rise of new groups. As Table 2 displays, after 1982, the network structure of business groups changed significantly and demonstrated greater segmentation, such that 62% of the groups became isolated from the main network (see year 1988). Only 4 directors participate in more
than one business group. Figure 2 displays a more fragmented network with the surviving business groups (blue nodes) and the new business groups (red nodes) with respect to the previous period. The Angelini business group is the most central occupying the role previously played by the state-owned one.

[INSERT FIGURE 2 AROUND HERE]

Between 1982 and 1989, Chile enjoyed stable economic growth under the authoritarian regime. Neoclassical economists praised the country’s economic policies (Montecinos, 2009), but human rights organizations condemned the widespread political repression (Kornbluh, 2013). The economy remained strongly dependent on mining exports, with a lower participation of manufacturers (Navia, 2013). Many countries in Latin America faced hyperinflation and uncontrolled foreign debt during these years, but Chile was an exception, marked by macroeconomic stability and growth (Cardoso & Helwege, 1992).

The telecommunications sector did not reprivatize as rapidly as other sectors. Contrary to what theory would predict for a limited access system such as Pinochet’s (Ahuja & Yayavaram, 2011; Henisz & Zelner, 2004; Moszoro & Spiller, 2014; North et al., 2009; Spiller, 2008), our analysis shows that CTC did not increase its number of links with other firms during the state ownership period. As Table 3 shows, there was a slight improvement in 1978 compared with 1970, but it did not compensate for the firm’s poor degree centrality. The authoritarian regime evidently did not perceive the need for incentives to build such links with other economic actors, possibly reflecting a government strategy of keeping tight control over a strategic sector while the military continued to consolidate its political power.

The privatization of CTC took place between 1987 and 1989, when the Australian Bond Corporation acquired the final government-owned shares. That same year, it approved a new capital
increase that consolidated Bond as the firm’s major shareholder (Bucheli & Salvaj, 2014). Therefore, the firm already had undergone privatization by the time Chile experienced its next major political transition, in 1990.

**Chile under a Democratic Open Market System**

In the late 1980s, Pinochet allowed some limited political opposition and called for a referendum, in which the people could choose between keeping him in power for eight more years or having democratic elections. Multiparty opposition in an environment of unprecedented freedom of expression, by the regime’s standards, led to Pinochet’s defeat. The general agreed to transfer power according to the terms of a constitution written by his inner circle and approved by another referendum. After the transition, Pinochet was allowed to remain a senator for life, and the armed forces retained political and economic privileges. Nor did the new democratic regime challenge Pinochet’s human rights record. He died in 2006 and was buried with the standard official honors reserved for former heads of state. Thus, Chile’s transition represents an agreed transition (Linz & Stepan, 1996), in that the pre-authoritarian elites remained economically powerful and strongly influential in politics. After the transition, Chile elected a president from a center-left coalition known as the Concertación.

The network structure of business groups during the Concertación democratic and open market regime shows that the main components and periphery remained stable (Table 2). That is, the center continued to be highly connected, but strong activity appeared among peripheral actors (marginal and isolated business groups), including business groups controlled by MNCs, which grew from 23% of the sample of business groups in 1988 to 41% in 1991, then decreased to 37% in 2010. As we show in Table 2, between 1999 and 2010, the rise in interlocked directorates created a big main component including 84% and 70% of the business groups, respectively. In 1990 business
groups shared 96 directors and in 2010 this number raises to 139 directors. Figures 3 and 4 reveal the more central or connected groups (centers of the figures), along with isolated groups at the peripheries. Blue nodes represent surviving groups from previous periods and the red nodes the newcomers. In 2010, the state-owned group recovered its protagonist role in the network, accompanied by three surviving groups from previous periods: Matte, Endesa and Claro.

In 1990, the Spanish MNC Telefónica Internacional acquired Bond’s shares and changed the firm’s name to Telefónica Chile CTC. As Table 3 indicates, the open access system did not discourage the Spanish investors from establishing links with other actors through interlocked directorates, though both political and economic transitions had consolidated by that time (they had followed a similar strategy in Spain; Calvo, 2008). In general, MNCs appear to have adopted strategies developed by domestic actors.

The privatization of ENTEL between 1986 and 1992 and its new ownership also reveals a different trend from what the theory of institutional voids would predict (Bucheli & Salvaj, 2014). Greater ownership by the domestic Hurtado-Fernández group, including its investment firm Almendral and the very powerful Consorcio de Seguros Generales and Consorcio de Seguros de Vida, meant that ENTEL built more connections with other firms and industries (Table 3). Similar to the case of Telefónica, the groups owning ENTEL had incentives to reinforce their existing network strategies.

Our sample represents an important segment of the Chilean economy; our unique databases support calculations of the interlocking networks for the entire Chilean economy. In Table 4, we present a general calculation of the average degree of centrality of the whole Chilean network, compared with the CTC and ENTEL networks individually. We uncover similar trends, such that a
more open political and economic system did not decrease incentives for network strategies but instead increased them.

[INSERT TABLE 4 AROUND HERE]

Both our calculations and historical evidence show that in a democratic/protectionist model, the rules imposed by the government and its influence in planning the economy provided incentives for the private sector to organize in business groups or establish close links among firms through corporate board interlocking. This process led to a concentration of the economy and increasingly fewer, larger firms. By the end of the 1960s, business groups sought to defend the fading protectionist model; the network strategies they had created to overcome the state-imposed obstacles also permitted them to acquire oligopolistic power. Therefore, these groups had strong incentives to protect the advantages they had under protectionism. When the market-friendly Pinochet replaced a democratic regime, the new order further incentivized business groups to reinforce their network strategy, because privatization put more assets at their disposal while they pursued a new, globally oriented economic regime. The 1982 economic crisis inspired a consensus between the military government and the business groups about which economic model to follow, though during the military regime, the firms seemingly lacked the necessary incentives to create links with the government, as theory predicts. After Chile’s re-democratization in 1990, the pluralistic regime did not decrease incentives for network strategies either. Instead, this strategy and its related governance structures consolidated as a primary strategy that organizations used to maintain economic power. In both the telecommunications sector and among business groups, network strategies not only survived but thrived.
DISCUSSION AND IMPLICATIONS

The survival of corporate strategies and governance structures related to institutional environments marked by political and economic voids is a paradox of great interest. Some scholars (e.g., Manikandan & Ramachandran, 2014) maintain that it arises because after an economic transition, the elites sense new growth opportunities and believe they can exploit the capabilities they have developed as business groups. This explanation relies on what Dunning and Rugman (1985) define as transactional market imperfections. Other scholars (e.g., Colpan & Hikino, 2010) argue instead that the best way for business groups to compete in a new, more globalized world is by protecting themselves, using networks they previously created. This view is what Dunning and Rugman (1985) classify as structural market imperfections.

With this study, we demonstrate that a transition in the institutional environment, from a limited to an open access system, can shift the nature of market imperfections from transactional to structural, which explains the survival of network strategies. The only way to understand how these imperfections respond to shifts in the institutional environment is by analyzing historical processes, which take place at the political and economic levels, in conjunction with those associated with governance and strategy at the organizational level. As Cantwell et al. (2010) predict, we find co-evolution between the institutional environment and organizations.

In turn, we highlight several points as relevant for organization and management literature and scholars interested in the political economy of international business. In particular, institutional voids in a pre-transition period increase transactional market failures, giving organizations incentives to internalize markets for efficiency. Efforts to fill institutional voids through networking endogenously create structural market imperfections though, so fewer, relatively larger firms gain the ability to close markets and preempt the entry of new firms with greater entry or mobility barriers,
which in turn increases their market power. As Porter (1981: 611) posits, “industry structure determines the behavior or conduct of firms.” In our analysis, the internally created oligopolistic market structure, designed to address the institutional voids of a limited access system with network strategies or business groups, encourages participants to guard their strategies and relationships after the institutional transition to an open access system. Filling institutional voids with network relationships can reduce transactional market imperfections, but it also can create structural market imperfections, by increasing firms’ size and reducing the overall number of firms. These findings suggest iatrogenic inadequacy, that is, the situation that emerges “when an attempt to resolve one fundamental problem leads to a failure in another market ordering mechanism” (Ahuja & Yayavaram, 2011: 1638). In the presence of post-transition structural market imperfections, firms still have incentives to maintain business groups or network relationships for their survival and performance (Carney et al., 2011).

The actors we study are relevant for understanding corporate strategy in a global economy. First, in studying emerging markets’ business groups, we challenge some theoretical notions of why they exist, in that we find no evidence they are more likely in countries with more institutional voids (Carney et al., 2011; Colpan & Hikino, 2010; Granovetter, 1995; Guillén, 2000; Khanna & Palepu, 1997, 2000; Leff, 1978). We thus contribute to debates about why these groups have survived and even thrived after institutional transitions from limited to open access societies (Colpan and Hikino, 2010; Kandel et al., 2013). Second, SOEs have become increasingly competitive in the world economy and even are rewriting some long-standing rules (Musacchio & Lazzarini, 2014). As we reveal, these firms also are significant actors in business groups, consistent with some recent findings (Colpan & Hikino, 2010; Salvaj & Couyoumdjian, 2015). In Chile, the SOEs’ strategy did not change with the adoption of a more democratic regime or in the presence of more open market systems.
Third, our findings with regard to the role of MNCs suggest that home country institutional characteristics matter when analyzing network strategies in other host countries. Telefónica’s network strategy was consistent with the way the company behaved in Spain, before it became an MNC (Martínez, 2008). Its network strategies likely were neither constrained nor determined by just the host country’s characteristics; the type of governance developed at home, reflecting the company’s home country’s institutional characteristics, exerted the main effect (see also Kandel et al., 2013).

Our findings and methodological approach also have several theoretical implications. In particular, when studying the relationship between an organization’s strategy and the institutional environment, it is imperative to understand the environment as a result of previous political and economic processes (Cantwell et al., 2010). However, the prediction that locals follow what MNCs do, in terms of strategy and structure, does not hold true. Rather, given Chile’s political and economic characteristics, it made sense for MNCs to follow the strategies developed by locals and create networks with different actors. To understand institutional transitions, it also is imperative to consider both path-dependent elements and any new incentives to retain pre-transition strategies and governance forms. The survival of network strategies and business groups is not simply a result of path dependence; it is a rational decision in response to a new type of market imperfection. We contribute to integrated analyses of corporate strategy and economic transitions (Lee, Peng, & Lee, 2008; Li, Peng, & Macauley, 2013; Peng, 2003; Zhou & Peng, 2010), by adding elements of political transitions from a historical perspective. Banalieva, Eddleston, and Zellweger (2014) note the benefits of research that accounts for institutional changes to understand changes at the governance and strategy levels. Our findings contribute as well to debates about the endogenous characteristics of the institutional environment. Khanna and Palepu (1997) suggest that a benefit of business group
creation is the development of certain political capabilities that arise in the pre-transition period to fill institutional voids but subsequently can help firms legitimize their existence in the post-transition world. In this case, “the larger the company, the easier it is to carry the cost of maintaining government relationships [functioning as] industrial embassies” (Khanna & Palepu, 1997: 46).

Government influence in the private sector does not necessarily decrease after a market transition (Khanna & Yafeh, 2007; Li et al., 2013), which generates private-sector incentives to retain previously successful network strategies and corporate governance structures.

In summary, we recommend rethinking the relationship between institutional voids and network strategies. Moreover, we call on scholars to reconsider the very notion of institutional voids, for which the conceptual framework developed by Dunning and Rugman (1985) may be especially useful. Developing strategies to fill institutional voids to address transactional market imperfections can make market transactions efficient, but they also can create a different type of structural market imperfection, which may or may not be efficient.

This study relied on painstaking archival work to build a database. Archival work is not common in business scholarship, but we believe it provides the most complete way to understand the relationship between individual organizations and the wider institutional environment.

The type of transition we analyze is not the only one possible; several countries recently have witnessed transitions toward more authoritarian regimes, such as Venezuela and Russia. Others have shifted from a mild democratization process to a new type of authoritarianism, as in Egypt after the Arab Spring. New brands of totalitarianism and authoritarianism continue to emerge, with consequences unpredictable for international business, such as the extreme theocratic movements in parts of Africa and Asia. We hope our study provides some theoretical and methodological starting points from which to investigate other types of transitions. Our findings also have implications more
broadly for practitioners and policy makers. The historical determinism of the relationship between different organizations in Chile is unique, as it would be for any nation. Successful experiences are difficult to reproduce without consideration of the historical processes that led to a particular status quo and the historically determined forces challenging it. The Chilean government for example pragmatically approached business groups, making their existence official and acknowledging the need to work with them—a move that in the long term provided the country with notable economic stability.

CONCLUSION

This paper illustrates the importance of historically informed research in management scholarship, with studies that account for the historical determinants of actions by organizations (MNCs, business groups, SOEs), in relation to the historically determined changes in the institutional environment. We examine why network strategies and their associated governance structures, typically related to limited economic and political systems, survive after a transition to more open systems. Whereas theory would predict that more open political and economic systems reduce incentives for network strategies, we show that the transition can generate a new incentive to keep these strategies and governance structures. We combine historical research with conceptual contributions and thus demonstrate that before the institutional transition, efforts to fill institutional voids, which resulted from transaction market imperfections, endogenously created structural market imperfections in the post-transition period. We thus call for a renewed view on how network strategies fill institutional voids, in a framework that acknowledges that any institutional environment is historically determined and co-evolves with the organizations that operate under its rules.
REFERENCES


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Table 1: Chile: Manufacturing Output as a Percentage of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Chile</th>
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<tbody>
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<tr>
<td>1928</td>
<td>12.6</td>
</tr>
<tr>
<td>1939</td>
<td>18</td>
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<tr>
<td>1950</td>
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</tr>
<tr>
<td>1955</td>
<td>18.8</td>
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<tr>
<td>1960</td>
<td>18.7</td>
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<tr>
<td>1965</td>
<td>25.4</td>
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<td>1970</td>
<td>25.2</td>
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Source: Own calculations, based on information from the Montevideo-Oxford Latin American Economic History Database.

Table 2: Institutional Transitions and Interlocked Network Relations of Chilean Business Groups, 1970–2010

<table>
<thead>
<tr>
<th>Year</th>
<th>1970</th>
<th>1988</th>
<th>1999</th>
<th>2010</th>
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<td>Democratic Open market</td>
<td>Democratic Open market</td>
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<td>Type of economic regime</td>
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<td>Open market</td>
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<td>18</td>
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<td>1548</td>
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<td>505</td>
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<td>6</td>
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</tr>
<tr>
<td>Total Number of companies in network</td>
<td>165</td>
<td>151</td>
<td>185</td>
<td>244</td>
</tr>
<tr>
<td>Economic system</td>
<td>Close</td>
<td>Open</td>
<td>Open</td>
<td>Open</td>
</tr>
<tr>
<td>Political system</td>
<td>Open</td>
<td>Close</td>
<td>Close</td>
<td>Open</td>
</tr>
<tr>
<td>Average degree of centrality for Chile's corporate sector</td>
<td>13</td>
<td>3</td>
<td>6</td>
<td>8</td>
</tr>
</tbody>
</table>
Figure 1: Network Structure for Chilean Business Groups, 1970

Note: Nodes represent business groups and ties between them through shared directors. The width of the tie represents the number of shared directors. The size of the nodes is associated with its betweenness centrality. The red color identifies those groups appearing in our analysis for the first time. Given that we use the year of 1970 as our starting point, all groups are red.
Figure 2: Network Structure of Chilean Business Groups, 1988

Note: Nodes represent business groups and ties between them through shared directors. The width of the tie represents the number of shared directors. The nodes’ size is associated with its betweenness centrality. Red nodes are those groups appearing in our analysis for the first time. Blue nodes represent those already present in the previous year in our analysis of 1970.
Figure 3: Network Structure of Chilean Business Groups, 1999

Note: Nodes represent business groups and ties between them through shared directors. The width of the tie represents the number of shared directors. Nodes’ size is associated with its betweenness centrality. Red nodes are those groups appearing for the first time in our analysis. Blue nodes represent those already present in the previous period.
Figure 4: Network Structure for Chilean Business Groups, 2010

Note: Nodes represent business groups and ties through shared directors. The width of the tie represents the number of shared directors. Nodes’ size is associated with its betweenness centrality. Red nodes represent those groups appearing for the first time in our analysis. Blue nodes represent groups already present in the previous years of our analysis.