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CASE STUDY ON PRIVATIZATION IN CHILE:
COMPANIA DE ACERO DEL PACIFICO (CAP)

Final

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I. Introduction

In late October, 1994, Roberto de Andraca, president and CEO of Chile's largest steel producing and mining firm, Compañía de Acero del Pacífico (CAP), was in a difficult position. As early as January 1994, rumors of a major reorganization of CAP had surfaced within the Chilean business community. At a special shareholders' meeting held in July of 1994, a reorganization had been approved in principle, and the president had been tasked with developing a viable plan. It was now late October. De Andraca and his management team would have to come up with a medium-term strategy to redirect the company, and soon.

Anxiety was mounting among CAP's key shareholders, who questioned the wisdom of the diversification strategy that CAP had undertaken just prior to its privatization and had continued to pursue aggressively. They were concerned about projections that the holding company, CAP S.A., was facing a net profit decline of 20% in 1994 due to reduced demand for steel and ore for the domestic construction industry. CAP's single largest shareholder, a Swiss investment group that had established the forestry company which was one of CAP's most profitable business units, was particularly uncomfortable with the diversification strategy and had expressed a strong interest in divesting their holdings.

Other investors, too, were becoming skeptical of CAP's performance. Symptomatic of this was the low price-to-book value ratio of 1:1 at which shares of the holding company, CAP S.A., were trading. By comparison, other similar companies, such as the copper products manufacturing operation, MADECO, had a price-to-book value ratio of 5:1.

Although CAP's price-to-book value ratio was low, its share price continued to benefit from the general market expansion. In fact, by late 1994, CAP's stock was trading at an all time high, and due to increased share prices and declining earnings, boasted a price/earnings multiple (P/E) of 30:1. CAP's employee-owners--who had begun to purchase shares around 1986, when CAP's stock was trading at a P/E of 5:1--took advantage of this situation and cashed out their holdings, thereby depleting employee ownership to about 10%, down from a high of 41% in 1991. Such a sellout by the company's executives and workers sent a strong signal to the market about CAP's performance and value. Although CAP stock had more than doubled in price in the previous year, many stock brokers were wary of CAP stock as they were uncomfortable with the direction and leadership of the company.

In a final blow, Chile's debt rating agency had reduced the rating on CAP debentures from AAA to B. De Andraca knew he had to respond to his shareholders with a strong plan for the future. If he did not act quickly, the market could yield painful and possibly deadly divestitures and share price declines.

II. The Debt Swap Program

From 1986 to 1988, CAP was able to take advantage of a unique debt swap program, providing the firm with an unanticipated source of new funds. This enabled CAP to improve its financial statements, thereby enabling the company to make new investments and to embark on a broad diversification program. It was a propitious watershed, and CAP's managers used it to aggressively expand the company.

The financial opportunity arose in 1986, when the Central Bank authorized CAP and other state-owned enterprises (SOEs) to repurchase their foreign currency denominated debt to international banks through the secondary debt market at an average discount of about 25% of their face value.[1] This situation resulted from the fact that commercial banks in the U.S., Canada, Europe, Japan, Hong Kong, and other industrial countries were carrying an exceptionally large inventory of non-performing sovereign loans in their portfolios in the 1980s. In order to reduce their losses, the banks were willing to sell these loans for a fraction of their value. A secondary market quickly developed to trade the loans.

Having purchased its foreign currency denominated debt at the discounted price, CAP delivered the note to the Central Bank of Chile. The Central Bank accepted the note and issued a 15-year note for the peso equivalent of the full face value of the original note, at the current market rate of exchange for the currency of the original note. In cases where the Central Bank had guaranteed the original note, the government was instantly relieved of its contingent liability as guarantor. The Central Bank also held periodic auctions of U.S. dollar denominated obligations of SOEs. The successful bidder could purchase these obligations at a discount of approximately 40%, return it to the Central Bank for conversion into a pesodenominated note for the equivalent of the full face value of the original, making a substantial profit in the process. CAP was a successful bidder on several occasions, thereby increasing the benefits of the debt swap program.

CAP's profits increased dramatically during these years. The company's net profits, which in 1985 were US$9.3 million, grew to US$15.5 million in 1986 and reached US$61.8 million in 1989. As financial statements from those years were unavailable, it is unclear as to what percentage of CAP's profits during this period resulted from normal business operations and what percentage was related to the debt swap. However, CAP's profits declined significantly after the debt swap program ended, as illustrated in CAP's consolidated balance sheet and in-

[1] **Privatization in Chile**, by Dominique Hatchette and Rolf Lüders, International Center for Economic Growth, 1993. According to Chilean foreign exchange traders involved in these transactions, the discount was sometimes as high as 55-60% of the face value of the loan.

come statement for 1990-1993 (Exhibit 1) and the consolidated balance sheets and income statements for its three major subsidiaries: Compañía Siderúgica Huachipato S.A. (steel production), Compañía Minera del Pacífico S.A. (mining), and Terranova S.A. (forestry) (Exhibit 2).

In addition to providing an unanticipated source of earnings, the purchase of its own notes through this program reduced CAP's foreign debt by more than 75%, thereby also relieving the company of significant foreign exchange risks. In December 1985, CAP had long-term debts totaling US$519 million; by 1988, this amount had been reduced to US$117 million. CAP's debt increased dramatically in the years following the debt swap program, reaching $517 million in 1993 (Exhibit 3).

III. CAP's Diversification

CAP utilized the windfall profits from the debt swap program to implement its corporate diversification program. This diversification was undertaken in accordance with a 1981 ministerial directive aimed at reducing the dependence of SOEs on government subsidies by transforming them into profitable business entities. The directive called for SOEs to reorganize their operations into holding company structures and authorized them to make direct investments in any sector which they believed would be profitable, regardless of whether they had prior experience in that sector. The government also stated that it would cease its financial support of unprofitable activities.

In 1986, CAP began its diversification by acquiring the pension fund AFP El Libertador. In 1987, the year CAP was privatized, it formed its real estate and construction companies. And, in 1988, it entered the forest products industry through the acquisition of Terranova S.A. By late 1994, CAP's portfolio included some 30 companies. Its primary areas of activity were steel manufacturing (through Compañía Siderúgica Huachipato S.A.), iron mining (through Compañía Minera del Pacífico S.A.), manganese extraction (through Manganesos Atacama S.A.) and forestry (through Terranova S.A.). CAP also owned a number of subsidiary and affiliate companies in the service sector, which contributed a relatively small percentage of the total profits of the holding company. These included a steel products import and distribution company, a pension fund management company, a real estate development company, and insurance and investment companies, among others.

Exhibit 4 provides the financial highlights of the major groups of companies in CAP's portfolio between 1990 and 1993. An organizational chart of the holding company and its affiliates as of December 1993 is provided as Exhibit 5.

A. Rationale for Diversification

A key consideration in CAP's diversification strategy, as for most successful conglomerates, was to take advantage of return differentials between various business sectors at a time when local capital markets were unable to meet the demand for new investment. A second rationale for diversification was to balance the negative effect of business cycles.

A number of other factors entered into CAP's diversification strategy as well. The iron ore mining operations were of interest to CAP for vertical integration reasons, which was part of the company's corporate strategy. The other mining operations were included in the holding company because they were related to the mining industry, in which CAP felt it had superior experience and knowledge, although they were not an integral part of the manufacturing of steel.

The steel products import and distribution affiliates were acquired in order to enable CAP to participate in the profits from the import of steel products. The company felt that if they failed to sell locally some steel products manufactured by their Huachipato plant, they might at least participate in a portion of the profit from a sale made by one of the steel import and distribution companies. In addition, these affiliates provided management positions with which CAP could reward individuals who played a key role in the company's privatization.

The forestry business was included purely for reasons of profit potential, which was also the primary reason for most of CAP's investments in service-related subsidiaries or affiliates. These investments were made in direct response to the government's directive for SOEs to reorganize as holding companies and engage in profitable activities in any sector. CAP also held a 50% equity stake in a trading company in Curaçao, due to De Andraca's prior experience with CAP in the Netherlands and his familiarity with the islands.

B. The Steel Group

Companía Siderúgica Huachipato S.A. (CHS), established as a legal entity in December 1981, was a steel company which supplied the domestic building industry. It produced steel ingots and rolled steel, and it was also authorized to acquire, install, and exploit industries which were complementary or related to iron and steel processing, or metallurgy. CHS was a fully integrated steel producer and the sole producer of steel made from iron ore in Chile. It produced its own pig iron by reducing iron ore in blast furnaces, transformed it into liquid steel in an oxygen converter mill and, after successive rollings, provided finished and semi-finished products for the market.

The Huachipato plant had a production capacity of over one million tons of liquid steel per year, with its production primarily oriented towards the domestic market. In 1993, the company had about 65% of local market share, with the remaining 35% imported from Brazil. CHS provided steel products to numerous sectors, including building and construction, metallurgy, mining, and canning and containers. The company also exported certain semi-finished products to other countries in Latin America, including Argentina, Ecuador, Peru, Uruguay, and several Central American countries.

As Chile's economy was liberalized, the company was exposed to global supply and demand factors and international market prices for steel. This had at times resulted in competition from cheaper imports, such as in 1992, when 51% of the local market utilized steel imported from abroad. Nevertheless, CHS was consistently profitable, even during the global recession of the early 1990s (Exhibit 4).

C. <u>The Mining Group</u>

Compañía Minera del Pacífico (CMP) was established as a legal entity in December 1981, at the same time as CHS. Its primary objective was to develop its own or third-party ore bodies of any kind. It would also explore, determine, claim, register, measure, and establish ownership and mining rights for all types of minerals and, in general, acquire mineral deposits under any title. In addition, CMP engaged in acquiring, selling, importing, and exporting minerals, and it acquired, built, and exploited working plants, smelters, ports, and ancillary installations.

CMP owned and continued to exploit deposits previously owned by CAP S.A. It owned proven and probable iron ore reserves exceeding one billion long tons of high, medium, and low-grade mineral. Its primary activities were directed to the export of minerals, iron ore, and pellets. While the majority of these exports went to Japan, an objective of CMP was to diversify their sales internationally and to leverage any advantages in mining-related businesses. In 1992, approximately 80% of revenues were from Japan, with additional new markets, such as Malaysia, added in 1993. Sales were generally made under long-term contracts defining prices and quantities on an annual basis. A five-year contract was signed in November 1992 during a visit to Japan by the president of Chile and the chairman of CAP S.A.

Although CMP had historically performed well, its profitability suffered during the global recession of the early 1990s. During this period, a slow-down in manufacturing, building, and industrial production resulted in a decreased demand for iron ore, steel, and other metal products. CMP's sales declined from US$236.6 million in 1990 to US$201 in 1993 (Exhibit 4). More alarming, however--and of greater concern to CAP's shareholders--was the fact that between 1992 and 1993, CMP's profits declined from $8.4 million to US$557 thousand. Although this was not fully explained by the company, one factor could have been the appreciation of the yen against the dollar in 1993 which, according to a note to CAP S.A.'s 1993 consolidated financial statements, resulted in a loss of US$10.1 million for the holding

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company. Given the fact that 80% of CMP's business was with Japan, it is likely that a significant percentage of this loss reflected in the books of the mining company.

Manganesos Atacama (MASA) was established by public deed in March 1941. Its primary objective was to participate in the mining and ferroalloy industry, with a concentration on the production of manganese. Aside from mining and production, MASA imported, exported, and traded minerals. Although the company's assets were impressive and it was consistently profitable, its sales and profit contribution in most years were small relative to the sector as a whole. In 1993, sales were US$8.1 million and net profits were US$612,000 (Exhibit 4).

D. The Forestry Group

Terranova, S.A. was established by a group of Swiss investors as a basic forestry development and wood products group of companies. Through related manufacturing entities, they also provided finished and semi-finished wood products, such as doors and wood moldings. Terranova was acquired by the CAP group in 1988, along with its subsidiaries Sociedad Forestal Millalemu S.A. (a tree plantation company), Andinos S.A. (a sawmill, lumber, and chip operation), Fibranova S.A. (primarily a fiberboard and MDF panels manufacturer), and Agronova Fruta S.A. (an agricultural company). In December 1993, Terranova sold and transferred its rights and shares in Agronova to CAP S.A.

Terranova's forestry reserves in Chile covered an area of 130,593 hectares by 1994, representing a value of US$192 million (Exhibit 6). More than half of the timber reserves were planted in fast growing radiata pine. The timber was used to supply the group's panel, door, and molding manufacturing operations for both export and domestic markets. Timber was also grown for pulp and chip purposes, as well as to provide standard lumber for building.

Shipments to markets in the U.S. and Europe, which represented 75% of Terranova's export sales, were distributed through independent retailers. The balance export shipments were sold directly to countries in Asia and the Middle east by a group of Chilean wood products manufacturers, in order to obtain better sales terms. Improvements in the Japanese and American markets in 1993 resulted in larger shipments and higher prices for elaborated wood and knotfree lumber. In the same year, revenues from the domestic market increased by 14%. Although exploitation costs also increased from 1992 due to the larger volumes shipped and higher costs of raw materials bought from third parties, the Terranova group of companies produced net income of US$10.8 million in 1993.

E. The Services Group

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CAP's subsidiaries and affiliates in the service sector were a diverse group of companies. The included AFP Libertador S.A. (a pension fund management company), Aster S.A. (an import and distribution company for the steel and mining sectors), Agronova Fruta S.A. (an undeveloped fruit production company acquired from Terranova), Cía. Naviera Santa Fe Ltda (A company formed to exploit land, marine, and air transportation); Immobiliara San Vicente (a real estate development company), and Inversiones Huachipato S.A. (an investment company holding shares in affiliated companies, primarily in the steel sector). Additional affiliated companies in which CAP held at least 25% of capital included Nueva Suiza (25%, a real estate investment company), UAP Seguros Generales (49%, a property and casualty insurancecompany), UAP Vida (49%, a life insurance company), and PORT International N.V. (50%, an investment and trading company located in Curaçao).

Overall, the companies in the services group were profitable for CAP S.A. One notable exception was the steel and mining import and distribution company, Aster S.A. In 1991, the year it was acquired by CAP, Aster posted a net income of US$140 thousand. In 1992, its profits rose to US$1 million, but in 1993 the company registered a deficit of US$200 thousand. These dramatic shifts were not fully explained by the company, although they could be linked to the performance of CAP's major holdings in the steel and mining sectors.

F. <u>CAP's Performance after Diversification</u>

CAP's diversification strategy seemed initially to have been successful. In fact, most of the holding company's new activities experienced a boom between 1986 and 1989. In recent years, however, CAP's growth had stagnated. In 1985, prior to the diversification, the company's net worth was approximately US$720 million. By April, 1994, CAP's net worth was US$789. This represented an increase of only 8.3 percent in 10 years, without taking into consideration any inflationary factors. Some of CAP's later acquisitions, such as the airline LAN Chile and a TV broadcasting station which were acquired in early 1994, resulted in losses for the holding company.

Moreover, the macroeconomic situation in Chile in the fall of 1994, was not the same as it had been when the diversification strategy was adopted. The GDP growth rate, which had averaged about 10% in the late 1980s, had dropped to about 4.5% by 1994, with unemployment increasing from 4% to 6% of the workforce. In addition, the domestic capital market in Chile had expanded to a point where funds for viable new projects were relatively easy to obtain. Chilean firms now also had access to international capital markets, which had not been the case when the diversification was undertaken. Furthermore, Chilean economists were forecasting only a slight increase in the growth rate (5.5-7.0%) for 1995. There were reasons to consider whether broad diversification still made sense for firms such as CAP.

IV. Reorganization is Proposed

As of July 1994, the single largest shareholder in CAP was Cía. de Inversiones Suizandina S.A., a Swiss investment group. Headed by Stephen Schmidheiny, one of the largest investors in Chile, the Swiss had established the forestry group, Terranova. Following CAP's acquisition of Terranova and its subsidiaries in 1988, the Swiss held a 29.5 percent equity stake in the holding company--six times the equity position of the second largest investor (Exhibit 7).

The Swiss were uncomfortable with CAP's aggressive diversification. They preferred to hold shares of individual companies which were part of a single industry or sector, rather than a conglomerate involving a wide range of unrelated businesses. They felt that the management of businesses in a diverse array of sectors was challenging under any circumstances, and particularly difficult in a developing country. Although Terranova itself had consistently been profitable, the Swiss were disappointed by the financial performance of CAP S.A. In addition, many of their shareholders were uncomfortable with the environmental practices of some of the industrial companies in the CAP portfolio.

Given these concerns, the Swiss investors were increasingly interested in divesting their holdings in CAP. However, they were reluctant to give up their interest in Terranova, which was established by them and for which they have positive financial expectations. After considering the alternatives, they felt it was reasonable to propose a reorganization of the holding company into three separate entities along functional lines: a steel and mining group, a forestry group, and a services group. They presented their proposal at a special shareholders' meeting in July of 1994. The shareholders agreed in principle to a restructuring and authorized De Andraca to develop a viable plan.

V. Factors Favoring Reorganization

A. CAP's Management of Growth

Institutional investors had questioned CAP's management of the holding company since its privatization. Despite the group's broad diversification, most of the cash flow necessary to provide a source of funds for reinvestment into new businesses came from depreciation rather than from profits. This was underscored by the fact that between 1985 (the year before CAP began its diversification) and 1994, the holding company's net worth had increased by only 8.3 percent. This poor performance had been largely camouflaged by the fact that CAP's stock had appreciated dramatically. Despite the near stagnation of the company's net worth, the price of its stock--which had fluctuated at around 1000 pesos between 1988 and 1992--doubled in 1993, climbing to 1776 pesos per share by year end and reaching 2850 pesos per share by late October 1994 (Exhibit 8).

To a great extent, the appreciation of CAP's stock reflected the overall economic growth of the country. Privatization in Chile opened new markets and generated new demand in most sectors; the CAP group was a direct beneficiary of this process. Investor interest in CAP's stock in 1993 and 1994 was also influenced by the euphoric market conditions prevalent in Chile at the time. The strong performance of many privatized companies, whose shareholders had been well rewarded and the positive demand for investments in the Chilean market were key factors favoring further investments in companies such as CAP. Investors eager to get in on the action did not always take the time to evaluate the underlying strength of the companies whose stock they purchased. Nevertheless, there were those who were concerned about CAP's ability to maintain the value of its shares without taking steps to significantly improve the company's net worth.

B. Other Factors

Many observers of the business scene in Chile believed De Andraca was a superb practitioner of public relations. In fact, De Andraca's nickname in some quarters was Mandrako el Magico, or Mandrake the Magician. They cited as evidence the fact that he had skillfully managed to keep the company's image untarnished in the local press despite troubling situations, such as the dramatic decline in the mining company's net profit in 1993, that should have prompted inquiries from the journalistic community. Santiago's largest newspaper, *El Mercurio,* was particularly cooperative in printing the carefully crafted press packages it received from CAP without editing. Some observers speculated that senior managers of *El Mercurio* may have held shares in CAP, giving them an incentive to cast the company in a positive light.

During 1994, the Chilean business community began to wonder whether the dramatic appreciation of CAP's stock in the past two years was a reflection of superior corporate leadership and business acumen, or whether it was due instead to an unusually favorable macroeconomic environment, highly effective corporate communications, or even sheer luck. Although CAP had more than tripled its share ownership and the appreciation of its stock had yielded outstanding returns for shareholders, there were many who questioned the long-term sustainability of these accomplishments.

VI. Alternatives to Restructuring

If the holding company was not reorganized, there was a strong possibility that the Swiss would follow through with their stated intention to divest of their shares. This would present CAP with the challenge of finding another major investor with sufficient capital to purchase nearly 30% of the holding company, or a large number of individual investors. As De Andraca saw it, there were three major avenues by which this could be accomplished: selling the shares directly on the Santiago Stock Exchange, private placement with a Chilean or foreign investor, or listing CAP shares as an American Depository Receipt (ADR) on the New York Stock Exchange.

A. Selling the Swiss Shares

The easiest and most direct route for the Swiss group to divest of their shares would be to sell them on the domestic stock exchange. In this way, they could easily cash themselves out and continue with their other investment activities. However, a large sale of nearly 30% of CAP's shares, even if done over a fairly lengthy period of time, would most likely drive the price of the shares down, in which case both parties would incur losses.

A second possibility, and one that would avoid the problems inherent in selling the shares through the exchange, would be for the Swiss to try to place their shares privately with one of the four or five major entrepreneurs in Chile who have the capacity to buy the shares, or to a foreign company interested in making an equity investment in steel, mining, or forestry. An assured source of necessary raw materials could be of interest to certain foreign companies which lack the availability of these basic resources in their own country.

B. Listing as an ADR

As an alternative to selling the Swiss group's shares on the domestic exchange or finding a single major investor, CAP could seek to obtain a listing on the New York Stock Exchange (NYSE) as an American Depository Receipt (ADR). Listing as an ADR is important to a foreign country primarily because it is a new, untapped source of capital. In addition, it provides the listing company with greater flexibility regarding the timing of a new listing. At any one time, investor reception to any new issue may be better in New York than on the local market; at other times, the reverse is true. The net financial effect on the shareholders in the home country is the same: any new issue, whether it is offered in the local securities market or a foreign one, dilutes the value of each share of stock following the successful new issue.

There are other reasons for which it may be useful for a company to seek a listing as an ADR. If a company exports its products to the U.S.--which was the case for CAP--an ADR listing can enhance its marketing and advertising programs. Moreover, an ADR listing provides foreign exchange to the company--funds which CAP could utilize to reduce its debt, to modernize its production operations in Huachipato, which would lower the cost of production and improve CAP's ability to compete in the Latin American Steel market. CAP could also use a portion of the funds generated through an ADR issue to make equity investments in other Latin American countries as they follow Chile's lead in the privatization of state-owned steel companies.

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ADR listings were not new to Chilean companies. As of late 1994, thirteen Chilean companies were listed on the NYSE (Exhibit 9). Among these were MASISA, a building materials company comparable to Terranova (36.5% of its share base in ADRs); SOQUIMICH, a chemical and mining company (31.7% of its share base in ADRs); the Chilean telephone company, CTC (23.9% of its share base in ADRs); and the highly successful copper products company, MADECO (20.4% of its share base in ADRs).

Chilean investors looked favorably upon companies with ADR listings. In fact, one factor cited for the continued increase in the price of CAP stock in 1994 was speculation that the company was about to be listed as an ADR. There was every incentive for CAP to pursue this option, whether or not it decided to restructure.

C. Factors Influencing the Swiss

Regardless of the mechanism used, if the Swiss investors sold their shares in CAP they would have to give up their interest in Terranova--a company they had established and for which they had positive financial expectations. The Swiss had extensive experience in forestry, and they were fully aware of the profit cycle of the industry. Aside from cash generated from a small amount of pruning halfway through the growing cycle, depreciation provides the only cash flow from a plantation until the trees reach the commercial size for which they were selected, at which point they can be harvested and sold. Terranova's plantations were half grown, with significant profits expected when they reached maturity in a few years. De Andraca realized this would have an impact on whether the Swiss would actually follow through with their stated intention to sell their holdings in CAP.

VII. Ramifications of Reorganization

CAP management considered the options, paying special attention to the potential effects of restructuring on CAP's current share value. A negative reaction could result in a large number of investors selling their shares, which would drive the price down. Some Chilean stockholders also thought that it was likely that if the holding company was reorganized along functional lines, as proposed by the Swiss, the Swiss shareholders would sell their interest in the steel and mining sector and the services group, retaining only their shares in the forestry company. This could also have a negative impact on the price of shares in the non-forestry groups, given the size of the Swiss group's equity stake.

Nevertheless, shareholders had agreed in principle to restructure the holding company along functional lines at the special meeting that took place in July 1994. It was now late October, and concerns about CAP's future was beginning to mount among investors. De Andraca could no longer postpone the task of drawing up a viable strategy for the company, with or without a reorganization, if a major sell-off of shares was to be avoided.

As he had done nearly ten years previously, when he faced the task of developing a rationale and strategy for CAP's privatization, De Andraca rolled up his sleeves and set to work. It was going to be another long night.

Exhibit 1 A

Balance Sheet CAP S.A.
December 31, 1993, 1992, 1991, 1990
In thousands of U.S. dollars

ASSETS	1993	1992	1991	1990
CURRENT ASSETS				
Cash and Banks	12,439	13,972	10,556	18,048
Time Deposits	17,589	5,101	8,688	33,042
Marketable Securities	7,548	7,869	6,048	4,503
Trade Accounts Receivable	65,683	60,764	51,170	68,315
Notes Receivable	9,828	14,398	13,097	17,350
Inventories	153,717	173,969	177,621	137,497
Sundry Debtors	20,987	20,319	19,745	15,583
Due from related companies	12,853	14,954	15,114	7,383
Prepaid Expenses	4,461	2,960	4,709	7,797
Refundable Taxes	13,014	9,160	20,319	12,969
Other Current Assets	3,795	4,038	1,370	1,784
TOTAL CURRENT ASSETS	321,914	327,504	328,437	324,271
FIXED ASSETS				
Land and Forests	195,862	174,864	141,693	125,162
Buildings & Improvements	429,504	423,042	422,451	412,167
Machinery and Equipment	1,142,965	1,085,902	1,074,348	1,039,834
Construction in Progress and Other	161,818	40,202	90,952	104,102
Technical Revaluation	102,697	102,583	106,879	106,886
TOTAL FIXED ASSETS - GROSS	2,032,846	1,826,593	1,836,323	1,788,151
Accumulated Depreciation	(934,357)	(884,298)	(868,697)	(802,767)
TOTAL FIXED ASSETS - NET	1,098,489	942,295	967,626	985,626
OTHER ASSETS				
Investments in Related Companies	64,756	70,677	49,861	24,057
Long-term Investments in other cos	173	129	35	45
Excess of cost over carrying value	1,122	1,456	0	0
Excess of carrying value	(204)	(265)	(103)	(241)
L/T accounts receivable	31,232	30,906	25,639	32,654
Due from related companies	2,876	46,553	24,612	112
Other	27,629	30,947	17,153	18,353
TOTAL OTHER ASSETS	127,584	180,403	117,197	74,980
TOTAL ASSETS	1,547,987	1,450,202	1,413,260	1,384,635

LIABILITIES AND
SHAREHOLDERS EQUITY

CURRENT LIABILITIES	1993	1992	1991	1990
Short term-bank	52,658	96,754	77,509	107,341
Current portion of L/T debt	95,032	59,511	75,109	33,567
Debentures	27,355	20,673	7,032	6,191
Current portion-Sub. Debt	3,597	6,023	7,421	3,316
Dividends Payable	4,948	5,239	5,358	5,850
Accounts Payable	27,139	24,929	25,302	22,279
Notes Payable	554	27	66	20,347
Income Taxes	653	97	241	722
Sundry Creditors	1,079	333	1,252	4,659
Due to related companies	49	2,677	21	6,376
Provisions	26,145	26,043	24,842	28,955
Retentions	3,777	4,011	2,914	2,384
Other Liabilities	188	0	0	445
Unearned Income	1,495	2,252	1,103	348
TOTAL CURRENT LIABILITIES	244,669	248,569	228,170	242,780
LONG-TERM DEBT				
Banks and Financial Institutions	301,893	221,844	216,262	231,433
Debentures	119,488	144,789	142,865	98,351
Notes Payable	1,019	997	3,135	4,566
Sundry Creditors	46,800	28,235	29,660	21,165
Provisions	43,827	38,770	31,248	25,232
Other	4,477	1,261	1,551	1,568
TOTAL LONG-TERM DEBT	517,504	435,896	424,721	382,315
TOTAL LIABILITIES	762,173	684,465	652,891	625,095
Minority Interest	2,908	111	117	104
SHAREHOLDERS' EQUITY				
Paid-in Capital	690,294	690,294	427,088	427,088
Reserves	21,828	20,523	206,928	206,930
Appropriated	45,549	42,468	114,554	101,672
Net income for the year	33,327	27,624	26,664	35,803
Interim Dividends	(9,369)	(9,833)	(10,288)	(12,057)
Deficit of Dev. stage enter	1,277	(5,450)	(4,694)	0
Retained Earnings	70,784	54,809	126,236	125,418
TOTAL SHAREHOLDERS' EQUITY	782,906	765,626	760,252	759,436
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	1,547,987	1,450,202	1,413,260	1,384,635

Exhibit 1

COMPANIA DE ACERO DEL PACIFICO

Consolidated Income Statement
For the years ended December 31, 1993,1992,1991,1990
In thousands of U.S. dollars

OPERATING INCOME	**1993**	**1992**	**1991**	**1990**
Sales	611,139	553,984	522,984	536,567
Cost of Sales	517,361	478,882	430,811	425,722
Gross Profit	93,778	75,102	92,173	110,845
Selling & Admin Expense	34,913	32,478	29,151	29,360
OPERATING INCOME(LOSS)	58,865	42,624	63,022	81,485
OTHER INCOME (EXPENSES)				
Financial Income	3,915	5,918	3,980	4,540
Equity earned of rel companies	4,959	5,259	5,085	3,795
Amort of excess carry value over cost	61	143	137	137
Other non-operating income	42,964	36,534	27,230	16,852
Equity in losses of rel companies	(352)	(1,278)	(696)	(185)
Amort of excess cost over carry value	(1,661)	(49)		(3,507)
Financial costs	(42,968)	(47,959)	(56,454)	(47,014)
Other non-operating expenses	(29,515)	(11,025)	(14,396)	(16,097)
OTHER INCOME (EXPENSES)- NET	(22,597)	(12,457)	(35,114)	(41,479)
				(41,479)
PRETAX INCOME	36,268	30,167	27,908	40,006
Income Taxes	2,506	2,537	1,236	4,184
				(8,419)
Minority Interest	435	6	8	19
				1,035
INCOME TAX & MINORITY INTEREST	2,941	2,543	1,244	4,203
NET INCOME	33,327	27,624	26,664	35,803

Exhibit 2A

COMPANIA SIDERUGICA HUACHIPATO S.A.

Consolidated Balance Sheet
December 31, 1990, 1991, 1992 and 1993
In thousands of U.S. dollars

ASSETS	1993	1992	1991	1990
CURRENT ASSETS				
Cash and Banks	1,621	840	1,580	1,301
Accounts receivable	37,502	53,393	36,880	55,750
Related companies	84,638	54,880	5,168	110,569
Inventories	81,170	93,007	111,519	79,158
Others	9,285	5,294	10,183	9,446
TOTAL CURRENT ASSETS	214,216	207,414	165,330	256,224
FIXED ASSETS				
Cost	877,850	765,383	794,633	758,000
Technical Revaluation	140,272	140,326	146,768	147,003
Accumulated Depreciation	(533,521)	(497,984)	(504,275)	(473,902)
TOTAL FIXED ASSETS - NET	484,601	407,725	437,126	431,101
OTHER ASSETS				
Related Companies	66,344	95,728		
Others	47,926	45,000		
TOTAL OTHER ASSETS	114,270	140,728	152,207	42,443
TOTAL ASSETS	813,087	755,867	754,663	729,768
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Related companies	66,351	63,684	54,928	51,349
Others	25,252	31,518	32,361	33,765
TOTAL CURRENT LIABILITIES	91,603	95,202	87,289	85,114
LONG-TERM DEBT				
Debentures	na	na	5,531	10,447
Related companies	156,897	129,293	146,233	137,117
Others	77,436	55,029	51,057	41,036
TOTAL LONG-TERM DEBT	234,333	184,322	202,821	188,600
Minority Interest	na	na	na	na
SHAREHOLDERS' EQUITY	487,151	476,343	464,553	456,054
TOTAL LIABILITIES SHAREHOLDERS' EQUITY	813,087	755,867	754,663	729,768

Source: Company Annual Reports

EXHIBIT 2

COMPANIA SIDERUGICA HUACHIPATO S.A.

Consolidated Income Statement
For the years 1990,1991,1992,and
In thousands of U.S. dollars

	1993	1992	1991	1990
Sales	348,470	326,610	258,440	287,159
Cost of Sales	(303,076)	(291,561)	(219,538)	(235,949)
Gross Profit	45,394	35,049	38,902	51,210
Selling & Admin Exp	(5,699)	(7,717)	(6,584)	(5,020)
OPERATING INCOME - NET	39,695	27,332	32,318	46,190
Non-operating income:				
Other income	31,855	17,541	22,664	16,755
Other expenses	(43,801)	(23,427)	(32,569)	(38,280)
INCOME BEFORE TAXES & MIN INT.	27,749	21,419	22,413	24,665
Income Taxes	(710)	(1,403)	(87)	(3,289)
Income Before Minority Int.	27,039	20,016	22,326	21,376
Minority Interest	na	na	na	na
NET INCOME FOR THE YEAR	27,039	20,016	22,326	21,376

Exhibit 2C
COMPANIA MINERA del PACIFICO S.A.

Consolidated Balance Sheet
December 31, 1990, 1991, 1992 and 1993
In thousands of U.S. dollars

ASSETS	**1993**	**1992**	**1991**	**1990**
CURRENT ASSETS				
Cash and Banks	2,984	2,962	842	2,704
Accounts receivable	28,684	15,650	30,570	30,851
Related companies	523	236	309	188
Inventories	45,288	63,693	47,882	39,010
Others	5,694	6,840	12,951	12,241
TOTAL CURRENT ASSETS	83,173	89,381	92,554	84,994
FIXED ASSETS				
Cost	731,361	732,484	738,822	723,384
Technical Revaluation	(45,504)	(45,673)	(46,894)	(46,724)
Accumulated Depreciation	(376,067)	(369,362)	(350,822)	(317,717)
TOTAL FIXED ASSETS - NET	309,790	317,449	341,106	358,943
OTHER ASSETS				
Related Companies	na	na	na	na
Others	8,893	12,252		
TOTAL OTHER ASSETS	8,893	12,252	9,687	13,384
TOTAL ASSETS	401,856	419,082	443,347	457,321
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Related companies	79,949	66,389	81,588	194,682
Others	25,321	22,283	25,631	21,591
TOTAL CURRENT LIABILITIES	105,270	88,672	107,219	216,273
LONG-TERM DEBT				
Debentures	na	na	na	na
Related companies	66,344	95,728	111,550	20,000
Others	14,947	11,413	11,949	11,656
TOTAL LONG-TERM DEBT	81,291	107,141	123,499	31,656
Minority Interest	1	3	139	20
SHAREHOLDERS' EQUITY	215,294	223,266	212,490	209,372
TOTAL LIABILITIES SHAREHOLDERS' EQUITY	**401,856**	**419,082**	**443,347**	**457,321**

Exhibit 2

COMPANIA MINERA del PACIFICO S.A.

Consolidated Income Statement
For the years 1990,1991,1992,and
In thousands of U.S. dollars

	1993	1992	1991	1990
Sales	201,018	195,360	247,701	236,650
Cost of Sales	(183,670)	(170,916)	(206,671)	(191,855)
Gross Profit	17,348	24,444	41,030	44,795
Selling & Admin Exp	(6,120)	(6,974)	(7,012)	(7,953)
OPERATING INCOME - NET	11,228	17,470	34,018	36,842
Non-operating income:				
Other income	8,184	7,208	3,824	5,436
Other expenses	(18,427)	(16,166)	(26,726)	(34,913)
INCOME BEFORE TAXES & MIN INT.	985	8,512	11,116	7,365
Income Taxes	(428)	(84)	(453)	(308)
Income Before Minority Int.	557	8,428	10,663	7,057
Minority Interest	na	na	(135)	(7)
NET INCOME FOR THE YEAR	**557**	**8,428**	**10,528**	**7,050**

Source: Company Annual Reports

EXHIBIT 2 i

TERRANOVA S.A.

Consolidated Balance Sheet
December 31, 1990, 1991, 1992 and 1993
In thousandands of U.S. dollars

ASSETS	**1993**	**1992**	**1991**	**1990**
CURRENT ASSETS				
Cash and Banks	486	259	438	666
Accounts receivable	23,845	17,770	13,133	11,737
Related companies	1,671	391	na	18,355
Inventories	22,907	14,817	15,784	13,655
Others	5,713	3,623	7,024	1,244
TOTAL CURRENT ASSETS	54,622	36,860	36,379	45,657
FIXED ASSETS				
Cost	312,035	217,676	187,940	193,002
Technical Revaluation	7,398	7,398	6,529	6,158
Accumulated Depreciation	(20,889)	(13,767)	(11,210)	(9,013)
TOTAL FIXED ASSETS - NET	298,544	211,307	183,259	190,147
OTHER ASSETS				
Related Companies	13,863	8,802	na	na
Others	9,862	27,923	22,293	2,783
TOTAL OTHER ASSETS	23,725	36,725	22,293	2,783
TOTAL ASSETS	376,891	284,892	241,931	238,587
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Related companies	92,710	47,754	37,903	64,876
Others	12,291	11,406	11,578	9,770
TOTAL CURRENT LIABILITIES	105,001	59,160	49,481	74,646
LONG-TERM DEBT				
Debentures	na	na	na	na
Related companies	42,877	8,560	10,000	15,868
Others	2,688	3,826	6,957	10,769
TOTAL LONG-TERM DEBT	45,565	12,386	16,957	26,637
Minority Interest	2,879	65	102	103
SHAREHOLDERS' EQUITY	223,446	213,281	175,391	137,201
TOTAL LIABILITIES SHAREHOLDERS' EQUITY	376,891	284,892	241,931	238,587

Exhibit 2

TERRANOVA S.A.

Consolidated Income Statement
For the years 1990,1991,1992,and
In thousands of U.S. dollars

	1993	1992	1991	1990
Sales	84,563	48,279	39,792	37,231
Cost of Sales	(56,697)	(34,478)	(30,297)	(25,178)
Gross Profit	27,866	13,801	9,495	12,053
Selling & Admin Exp	(10,740)	6,580	(5,711)	(8,501)
OPERATING INCOME - NET	17,126	7,221	3,784	3,552
Non-operating income:				
Other income	3,576	8,592	9,918	8,783
Other expenses	(8,528)	(5,917)	(8,159)	(8,853)
INCOME BEFORE TAXES & MIN INT.	12,174	9,896	5,543	3,482
Income Taxes	(878)	(590)	(285)	(249)
Income Before Minority Int.	11,296	9,306	5,258	3,233
Minority Interest	(434)	na	2	(10)
NET INCOME FOR THE YEAR	10,862	9,306	5,260	3,223

Source: Company Annual Reports

Exhibit 3
Long-Term Debt 1990-1993
(In thousands of US dollars)

1990382,315

1991424,721

1992435,896

1993517,504

Source: Company Annual Reports

Exhibit 4

Financial Highlights of CAP's Major Subsidiaries
(in millions of US dollars)

Steel Group		Assets	Net Income	Sales	Equity
Compañía	1990	729	21	287	456.0
Siderúgica	1991	754	22	258	464.5
Huachipato	1992	755	20	326	476.3
	1993	813	27	348	487.1
Mining Group					
Compañía	1990	457	7.0	236	209.3
Minera del	1991	443	10.5	247	212.4
Pacifico	1992	419	8.4	195	223.2
	1993	401	.557	201	215.2
Manganesos	1990	6.0	.8	5.9	4.6
Atacama	1991	6.3	1.0	7.4	5.3
	1992	7.1	.524	6.8	6.0
	1993	7.2	.612	8.1	6.2
Forestry Group					
Terranova SA	1990	238	3.2	37	137.2
	1991	241	5.2	39.7	175.3
	1992	284	9.3	48.2	213.2
	1993	376	10.8	84.5	223.4
Services Group					
Aster S.A.	1990	NA			
	1991	11.5	.140	.643	8.0
	1992	18.8	1.0	17.9	10.8
	1993	21.6	-2.08	14.3	10.6

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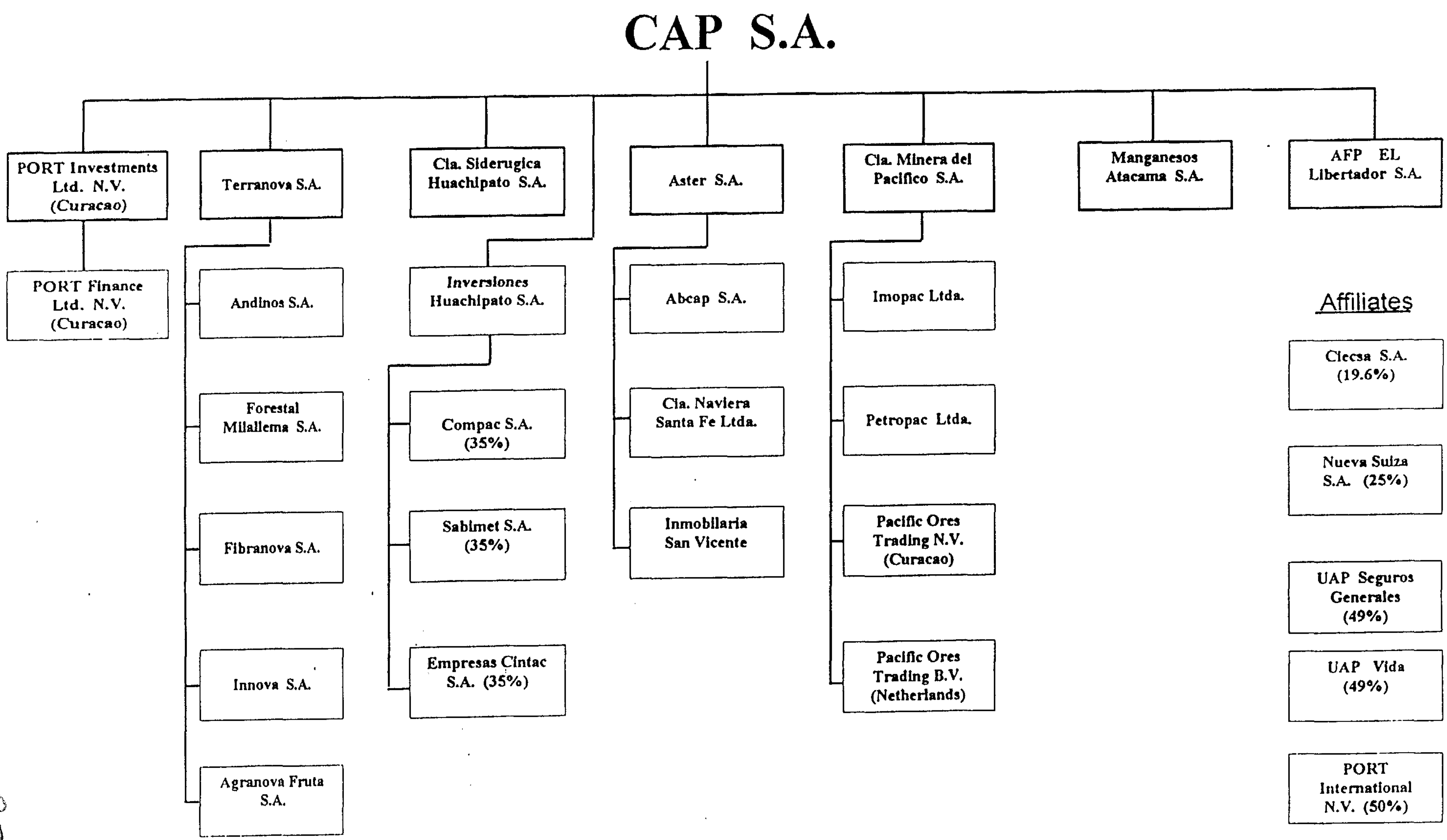
Exhibit 4, page 2

		Assets	Net Income	Sales	Equity
Abcap S.A.	**1990**	5.2	.937	8.6	4.0
	1991	5.6	.799	10.3	4.2
	1992	5.3	.319	8.7	4.0
	1993	6.1	.667	6.6	5.4
AFP EL	**1990**	4.4	1.4	7.8	3.5
Libertador	**1991**	4.8	.867	8.0	3.9
	1992	5.8	.616	9.5	4.8
	1993	6.7	.725	9.9	5.4
PORT	**1990**	.819	.345	.427	.804
Investments	**1991**	1.4	.591	.569	1.3
Ltd	**1992**	2.5	.82	.36	1.4
	1993	1.8	.408	.547	1.8

Source: Company Annual Reports

Exhibit 5
Organizational Chart of CAP S.A.



Source: Company Spokesman

Exhibit 6

Terranova S.A. Forestry Reserves

	Hectares	Radiata Pine	Native Forests	US $ Value
1991	102,747	57,593	60,761	131 Million
1992	111,975	63,761	60,761	163 Million
1993	130,593	70,541	60,761	192 Million

Source: Company Annual Reports

Exhibit 7

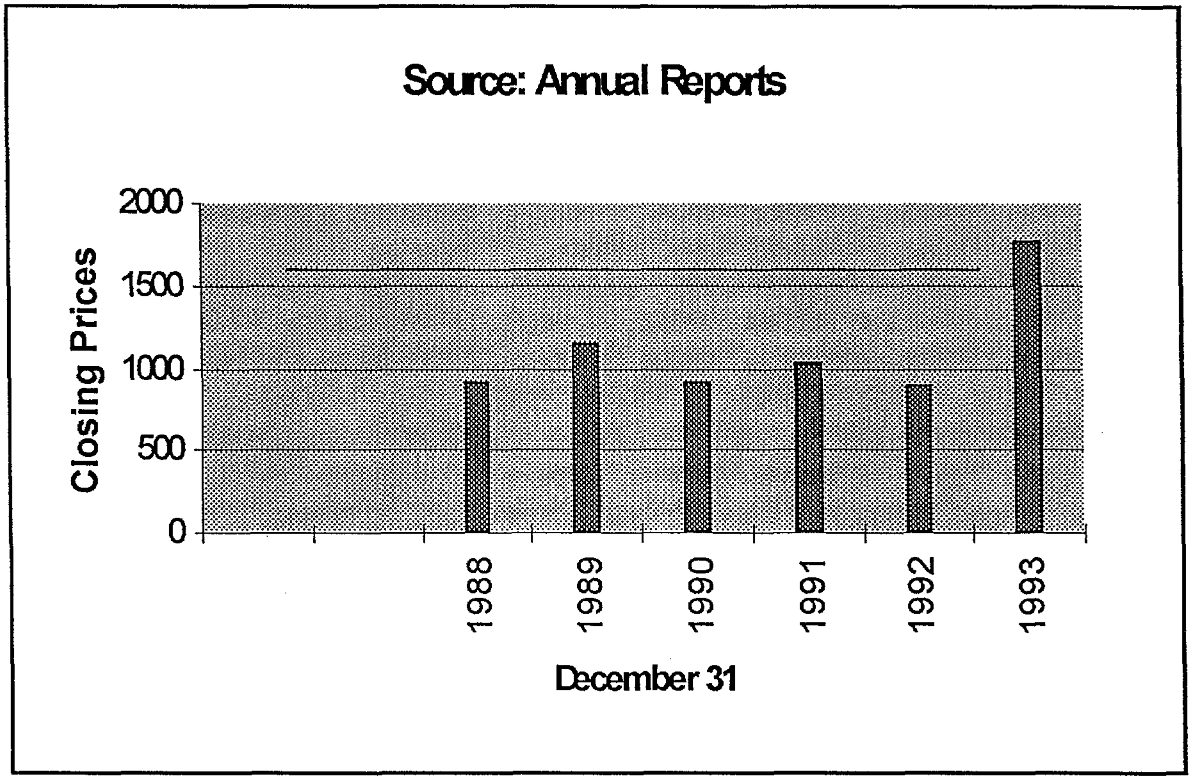
TEN LARGEST SHAREHOLDERS IN CAP S.A.
(December 31, 1993)

Shareholders	No. of Shares	Percentage
1. Cía. de Inversiones Suizandina S.A.	44,536.424	29.5 %
2. M.C. Inversiones Ltda.	7,287,014	4.8%
3. Cía. Explotadora de Minas S.C.M.	5,903,198	3.9%
4. Rand Corporation S.A.	4,372.733	2.9%
5. A.F.P. Habitat S.A.	3,863.927	2.5%
6. A.F.P. Santa María S.A.	3,001,464	2.0%
7. A.F.P. Provida S.A.	2,856,053	1.9%
8. Inversiones Aegis Chile S.A.	2,800,950	1.8%
9. Fundación CAP	2,449,217	1.6%
10. Genesis Chile Fund Ltd.	2,410,857	1.6%

Source: Company Annual Reports

Exhibit 8

CAP S.A. YEAR-END CLOSING PRICES, 1988-1993
(Chilean Pesos)



December 31	Closing Prices (in Chilean Pesos)
1988	905
1989	1142
1990	909
1991	1021
1992	900
1993	1776

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Exhibit 9

Chilean Companies with ADR Listings on NYSE
(September 1994)

Company	Industry	% of Shares in ADRs
MASISA	Building materials	36.5 %
SOQUIMICH	Chemicals and mining	31.7 %
CRISTALERIAS	Crystals	27.1 %
CTC	Chilean Telephone Co.	23.9 %
MADECO	Copper products	20.4 %
LAB. CHILE	Pharmaceuticals	14.4 %
ANDINA	Bottling company	14.2 %
CERVEZAS	Brewing company	12.3 %
O'HIGGINS	Banking and financial services	10.0 %
CHILECTRA	Public electric utility	9.0 %
ENERSIS	Holding company, major investments investments in electric power	7.6 %
CHILGENER	Electric power generation	5.8 %
ENDESA	Holding company, major investments in hydroelectric power companies	1.5 %

Source: El Mercurio, November 3, 1994

I. The Reorganization Plan

On Friday, October 28, 1994 Roberto de Andraca called a private meeting of CAP's public relations officers to announce the reorganization of Compañía de Acero del Pacífico into three separate entities. He wanted to ensure that the necessary public relations program describing the reorganization plan would be carefully crafted and widely disseminated to insure a favorable response from shareholders. De Andraca knew that he could count on the full cooperation of El Mercurio, and other local newspapers, to accept all material in the press package prepared by the CAP PR department, and that they would print it.

The following Monday, Santiago's papers carried all of the details provided to them by CAP, including the structure of the new companies, the terms of the new stock issues, and the dates of their initial listing on the Santiago Stock Exchange. Now, all that remained to be seen was how the Chilean stock market, CAP's investors, and the general public would react to the newly reorganized enterprises.

As reported in *El Mercurio,* De Andraca announced that CAP was reorganizing its holding company investments into three separate entities, along functional lines. Its steel and mining operations would form one company, which would be managed by CAP under its existing name (CAP S.A.). CAP's holdings in the forestry industry would be combined into a new corporate entity, Forestal Terranova S.A. This company would be listed on the Santiago Stock Exchange, with trading to begin on November 9, 1994. A second new company, Invercap S.A., would comprise CAP's holdings in the service industry. As with Forestal Terranova, Invercap would be listed on the Santiago Stock Exchange and would be traded as of November 9. De Andraca stated that on November 14, 1994, each CAP shareholder of record as of November 8, 1994 would receive one share each of Forestal Terranova S.A. and Invercap S.A. for each share they held in CAP S.A.

The breakup of the original holding company, CAP S.A., was based upon financial statements as of April 30, 1994. *El Mercurio* reported that CAP's consolidated net worth as of that date (approximately US$778 million) was distributed as follows: 55.76% to CAP S.A., 28.59% to Terranova S.A., and 15.65% to Invercap S.A. [1] Exhibit 1 provides a new organizational chart for the three new entities. Post-restructuring balance sheets are provided as Exhibit 2.

[1] "Terranova e Invercap a la Bolsa," **El Mercurio**, October 31, 1994.

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II. The New CAP S.A.

The reorganized CAP S.A. was comprised of firms which were mainstays of the Chilean steel and mining industries: Cía. Siderúgica Huachipato S.A., Cía. Minera del Pacífico S.A., Manganesos Atacama S.A., Cía. Distribuidora de Petroleos del Pacífico Ltda., and IMOPAC Ltda. The principal contributor to the group's earnings was Cía. Siderúgica Huachipato S.A., a steel company which supplied the domestic building industry. Although smaller contributors to profits, other holdings of CAP S.A. included in the steel and mining group after the reorganization were Petropac S.A., Pacific Ores & Trading N.V. (Curaçao), Pacific Ores & Trading B.V. (Netherlands), PORT Investments Ltd. N.V. (Curaçao), and PORT Finance Ltd. N.V. (Curaçao).

III. Forestal Terranova S.A.

Forestal Terranova S.A. was comprised of CAP's former holdings in the forestry sector, including Terranova S.A. and all of its subsidiaries and affiliates. The new company would be managed by the Swiss investor group which owned nearly 30% of the CAP holding company prior to re-organization.

Numerous observers believed that Hernán Buchi, the former CORFO official and Minister of Finance who had been a major figure in the Chilean debt recovery and a key player in the privatization program, would be named president of Forestal Terranova shortly after the reorganization. As many had expected, it was reported that the Swiss group planned to gradually sell its shares in CAP S.A. and Invercap following the reorganization and increase its investment in Terranova S.A. to 44 percent.

IV. Invercap S.A.

Invercap S.A. was comprised of CAP's former holdings in the services sector and would be managed by executives of the existing CAP organization. Invercap appeared to have inherited from CAP S.A. the role of holding company for investments in a wide range of unrelated sectors, including fruit farms, steel importers, a pension fund, insurance companies, and communications companies. Of potential strategic value to CAP S.A. was the fact that several of its affiliates in the Invercap group (Compac S.A., Sabinet S.A., and Empresas Cintac S.A.) served as distributors, importers, or processors for the iron and steel industry. Some observers thought that De Andraca would eventually sell most of these in the next few years, with the exception of the steel-related companies and the pension fund.

V. Looking Toward the Future

As he read the articles in *El Mercurio* and the other papers, most of which were favorable, Roberto de Andraca reviewed the factors that he had weighed in charting a new course for the company. He felt he had made the best possible decision and that the restructuring would significantly enhance the future business prospects for CAP and its affiliates. It was now up to CAP's shareholders and the market to respond to the announcement. He hoped it would be well received, so that he could move ahead with his other plans to strengthen the reorganized company, including listing CAP shares as an ADR on the New York Stock Exchange.

Exhibit 1
Organizational Chart of the New Companies

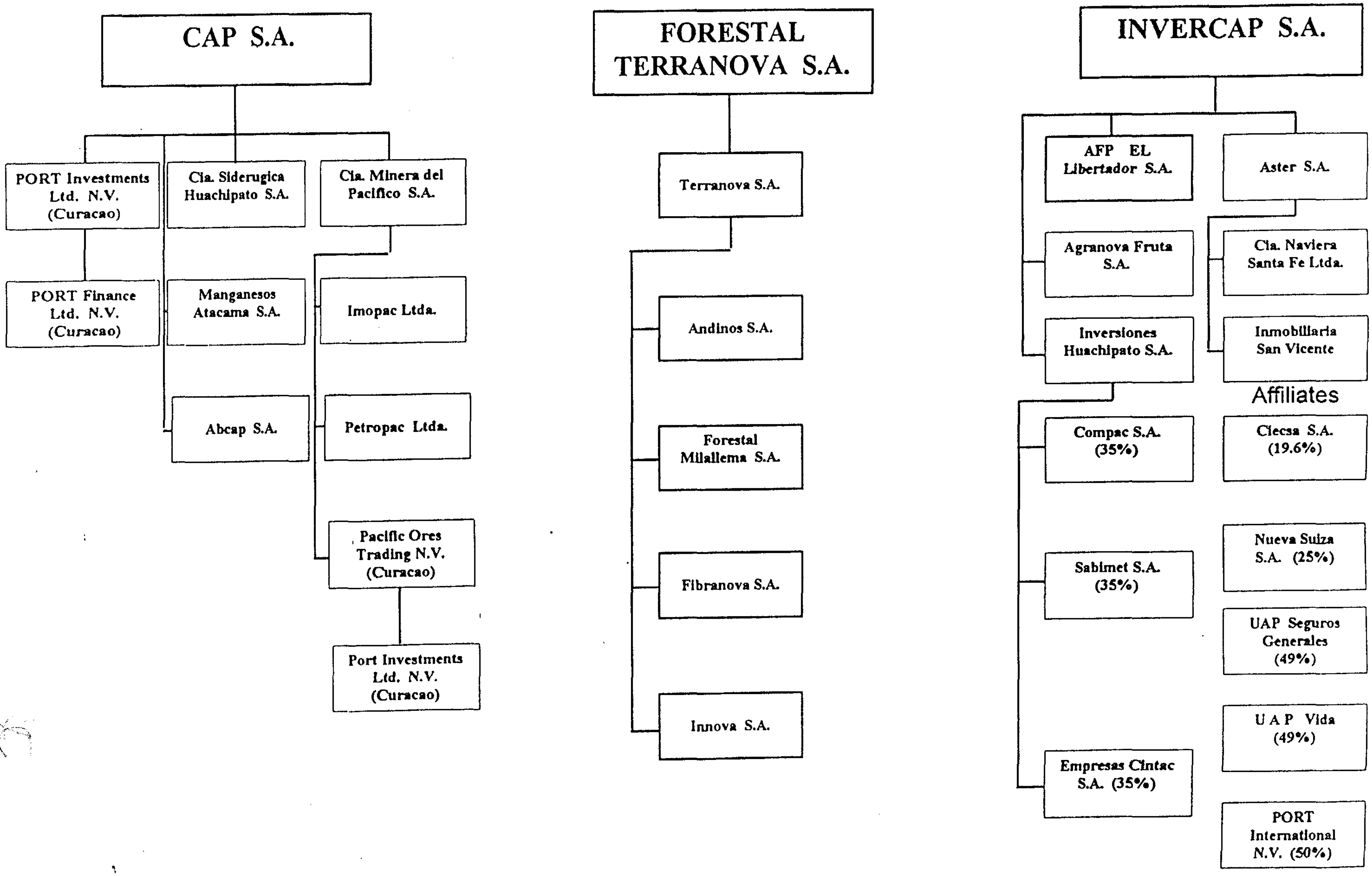

Exhibit 2

NEW BALANCE SHEETS-AS OF APRIL 30, 1994

CAP S.A., Terranova S.A. and Invercap S.A.

In thousands of U.S. dollars

ASSETS	OLD CAP	NEW CAP	INVERCAP	TERRANOVA
CURRENT ASSETS				
Cash and Banks	7,887	6,931	220	736
Time Deposits	15,580	15,580		
Marketable Securities	871	135	736	
Trade Accounts Receivable	72,310	54,511	1,500	16,299
Notes Receivable	7,612	3,371	579	3,662
Inventories	23,984	16,179	3,524	4,281
Sundry Debtors	21,819	98,438	58,717	
Due from related companies	158,580	127,141	5,833	25,606
Prepaid Expenses	19,706	13,888	869	4,949
Refundable Taxes	7,400	7,193		207
Other Current Assets	4,416	4,409	5	2
TOTAL CURRENT ASSETS	340,165	347,776	71,983	55,742
FIXED ASSETS				
Land and Forests	198,896	2,605		196,291
Buildings & Improvements	430,559	400,238		30,321
Machinery and Equipment	1,141,325	1,067,891	106	73,328
Construction in Progress and Other	231,638	215,350	316	15,972
Technical Revaluation	102,700	95,302		7,398
TOTAL FIXED ASSETS - GROSS	2,105,118	1,781,386	422	323,310
Accumulated Depreciation	(955,257)	(931,988)	(76)	(23,193)
TOTAL FIXED ASSETS - NET	1,149,861	849,398	346	300,117
OTHER ASSETS				
Investments in Related Companies	53,471		53,831	139
Long-term Investments in other cos	112			112
Excess of cost over carrying value	1,049		1,049	
Excess of carrying value	(189)		(189)	
L/T accounts receivable	23,814	15,903	579	7,332
Due from related companies	2	2		
Other	30,165	22,873	7,150	142
TOTAL OTHER ASSETS	108,424	38,778	62,420	7,725
TOTAL ASSETS	1,598,450	1,235,952	134,749	363,584

Exhibit 2, Page 2

LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Short term-bank	53,090	53,090		
Current portion of L/T debt	91,146	90,434		712
Debentures	31,064	31,064		
Current portion-Sub. Debt	3,788	3,495		293
Dividends Payable	3,048	3,048		
Accounts Payable	27,469	21,258	352	5,859
Notes Payable	355	105		250
Income Taxes	1,561	1,204	1	356
Sundry Creditors	32	32	11,404	123,932
Due to related companies	26,611	24,204	182	2,724
Provisions	2,556	2,217	6	333
Retentions	320	292		28
Other Liabilities	912	175	614	123
Unearned Income	280	280		
TOTAL CURRENT LIABILITIES	242,232	230,898	12,559	134,610
LONG-TERM DEBT				
Banks and Financial Institutions	353,392	351,812		1,580
Debentures	122,927	122,927		
Notes Payable	1,051			1,051
Sundry Creditors	52,877	52,851		26
Provisions				
Other	38,902	38,754	47	101
TOTAL LONG-TERM DEBT	3,798	3,798		
TOTAL LIABILITIES	572,947	570,142	47	2,758
Minority Interest	3,298	33	44	3,221
SHAREHOLDERS' EQUITY				
Paid-in Capital	690,294	379,445	114,112	196,737
Reserves	23,065	1,207	5,177	16,681
Appropriated	66,610	54,227	2,806	9,577
Net income for the year	4		4	
Interim Dividends				
Deficit of Dev. stage enter				
Retained Earnings				
TOTAL SHAREHOLDERS' EQUITY	779,973	434,879	134,749	363,584
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	1,598,450	1,235,952	134,749	363,584

I. Case Overview

COUNTRY:	Chile
INDUSTRY:	Steel, Mining
DECISION-MAKER:	President and CEO of firm
ISSUES:	Management and financial analysis of privatization; post-privatization corporate strategy

In July, 1985, the president and CEO of Chile's largest steel producing firm faces serious problems in managing the re-privatization of his firm. Formerly private but for the past 15 years state-owned, the firm has a low and extremely variable profitability record, the international steel industry continues to suffer from a glut of over-capacity, and the Chilean economy remains depressed after the severe economic crisis of 1982-83. Although key officials in the Chilean Ministry of Finance energetically support at least partial re-privatization of the firm, important sectors of the military oppose the sale. Key executives in the firm also oppose active involvement in the re-privatization. For the CEO, however, re-privatization is imperative. State-owned firms confront restrictive investment controls, and as an SOE, the firm can not modernize aging production process, expand vertically, or diversify into areas that would stabilize cyclical steel earnings. The CEO must consider all possible options to sell 49 percent of the company's recently expanded equity capital. He assumes that with 49 percent private ownership, the firm will easily gain majority (and then complete) private ownership. Creating a financial package to enable the firm's workers to become shareholders, and buying back 20 percent of the firm's total capital, emerge as viable mechanisms.

Case (B) documents that the company's top management utilized both mechanisms to reach 49 percent private ownership, and full privatization followed swiftly. The privatized firm subsequently posted strong profits, and shareholders realized significant gains.

Case (C) and the Epilogue deal with a new set of problems for CAP management. While its share value had increased dramatically in late 1993, CAP's earnings had declined and concerns among key investors emerged in early 1994. As a solution, CAP management breaks up the holding company into three distinct enterprises: CAP S.A., comprised of CAP's holdings in the steel and mining industries; Forestal Terranova S.A., comprised of CAP's former holdings in the forestry and forest products industries, and Invercap S.A., comprised of CAP's former holdings in the services sector. These companies were listed on the Santiago Stock Exchange in November 1994.

II. Case (A) - Learning Objectives

1. *How to manage privatization.*Through the CAP case study, student participants will gain experience thinking strategically about privatizing a state-owned company. The case will help students develop analytical skills critical in evaluating: 1) different mechanisms for completing privatization, and 2) different target groups as potential investors. Participants will weigh costs and benefits of different mechanisms in light of complex interrelations and tradeoffs among government and enterprise objectives.

2. *How to value the enterprise.* Contrasted against the firm's own earnings-based projections, students will evaluate different forms of valuation analysis including discounted cash flow, market value, book value, and liquidation value. The case will underscore the complexity and difficulty -- as well as the importance -- of estimating cash flows and the firm's discount rate accurately.

3. *How to sell shares to workers.* Participants will work through the specific components of a financial package designed to make worker investment in the firm's shares viable. The effectiveness of firm leadership, and the quality of labor-management relations also emerge as key elements of creating worker-shareholders. Participants will weigh the costs of the financial incentives against the benefits of worker share ownership.

4. *Thinking through other mechanisms.* The company's share repurchase highlights the importance of building momentum in the privatization process, and encourages participants to think strategically about completing privatization. Case participants will evaluate the firm's liquidity and work through the details of the share buyback, exposing significant problems including a reduction in the firm's net worth. The move also marks a retreat in the firm's contribution to capital market development, thus conflicting with other government objectives.

III. Discussion Questions

1. What are the most important benefits to re-privatizing the Compañía Acero del Pacífico? Should De Andraca push hard for majority private ownership?
2. Which of the government's central goals are served in supporting CAP's privatization?
3. What are the primary obstacles to selling CAP's shares? Which are the most serious?
4. How should De Andraca sell these shares? What should his re-privatization strategy be? What mechanism(s) should he utilize?
5. At what price should he sell CAP's shares? To workers? What other terms should be included in the financial package to induce workers to purchase shares? Would you recommend that De Andraca move forward with the worker purchase scheme?

6. Is the share buy-back option viable legally and financially? At what price should De Andraca buy back shares from the government? Are there disadvantages to this mechanism?

IV. Teaching Plan and Case Analysis

The following few pages provide a suggested framework for analyzing and teaching CAP Case (A). As will be stressed again, this framework can be modified in numerous ways, ranging from the amount of discussion time allotted to each section of the case, to the level of sophistication applied in financial analysis. As written, the intended audience for the case are government ministers with technical expertise equivalent to a first-year United States MBA program, or higher. The recommended time allotment for the following 5 discussion sections is: re-privatization--15 percent; valuation--40 percent; worker share purchase--20 percent; share repurchase--15 percent; and closing--10 percent.

1. Re-privatization. The first part of the case orients the student to the imperative of reprivatizing the firm, and explains the agendas of the case's principal actors. First, from the company's perspective, students should be asked to prioritize the principal advantages of privatization (in both qualitative and quantitative terms), and make a preliminary effort at weighing these benefits against costs. Discussion could be started with several questions: **Should De Andraca push re-privatization? If so, why?** Students' responses to this question could be summarized in concise terms on the chalkboard under pro and con headings. The case includes few cons to re-privatization itself -- only to the different mechanisms considered. Re-privatization emerges as the only viable way to save CAP from certain demise under current government policies.

Discussion should then cover the government's perspective. **Did CORFO want to privatize CAP? Was the entire agency in favor of the firm's privatization?** The case points out divisions within the government and CORFO. Students should identify Hernán Buchi, the key figure in favor, as motivated by a strong ideological free-market agenda and pressed by the need to raise money for the government's social programs. General Hormazábal, the principal military character opposed, viewed CAP's privatization in non-economic, military terms. The key point to establish for later discussion is that the political viability of De Andraca's choice of privatization mechanisms (particularly the worker share purchase program) will be influenced by military opposition. Before leaving this section, students should also address the question: **What were the government's goals and priorities in 1985?** Discussion should center on lessons learned from Chile's previous privatization experience (1974-1985). The government's principal goals were screening financially-weak investors, raising revenue, and widening share ownership.

What are the most formidable obstacles facing De Andraca, and what must he accomplish? Here, compiling a simple list on the chalkboard will give students an ongoing reminder of the difficulties involved. These include, among others: military opposition, CAP management opposition, the depressed Chilean economy, overproduction in the steel industry, CAP's indebtedness and low profitability, and the dearth of potential investors. What he must accomplish is placing all the shares from CAP's 1984 issue in private hands. This will bring private ownership up to 49 percent; from here, he and top management expect that majority private ownership will be within easy reach. Note that this is only an assumption, but that CAP's entire privatization strategy is based on it. Appendix 1 shows graphically the 1984 equity expansion's effect in diluting CORFO's share ownership to 51 percent. Note this and other appendices could be used as transparencies during the final, closing section of the case discussion.

2. Valuation. Preliminary work on valuation analysis is a central learning objective of this case. From the benchmark of the firm's own after-tax earnings projections (case Exhibit 8), the instructor can delve into a rich array of valuation issues, ranging from net present value to sophisticated financial theory. Discussion on this section could begin with a general review of CAP's profitability, centering around a question like: **How do you feel about buying CAP?**, or **What do we know about CAP's profitability in 1985?** If already not done, students should evaluate: the firm's variable and low 1975-85 earnings record (case Exhibit 4); the impact of government restrictions on CAP's investments (case Exhibit 7); and the company's indebtedness. On this last point, students should be encouraged to assess exactly how indebted CAP was, and whether or not this is a significant concern from an investor's viewpoint. Information in the case shows that although CAP's D/E ratio is moderate (in a very general sense), its EBIT/I ratio gives some cause for concern about CAP's ability to cover the high costs of its dollar-denominated debt. The instructor can of course apply additional techniques of financial analysis.

Projected Earnings. Case Exhibit 8 lays out consolidated earnings projections as actually submitted to De Andraca in 1984 (note earnings were estimated through 1990, and held constant 1990-94). Dividing net profit by the number of shares, you get net earnings per share (EPS), as CAP derived its own valuation. In evaluating these projections, several points can be made by the instructor. First, students should recognize that numerous assumptions are made in order to project earnings into the distant future; the reliability of these projections is weakened by the cyclical and highly-variable nature of earnings in the steel industry. CAP's own projections included annual GNP growth of 2 percent 1985-90, and annual inflation of 30 percent over the same period. The instructor should return to these assumptions in the discussion of Case (B). Second, the instructor can draw attention to the extraordinary nature of earnings that includes income from the placement of shares. Appendix 2 discounts both EPS projections at 16 percent. Discussion could center on whether or not this is appropriate

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(note also that income from the sale of share in 1990 is assumed constant for the next four years).

The most important discussion issue, however, is the distinction between earnings per share (EPS) and discounted cash flow as forms of valuation analysis. The instructor should explain the consensus view that a firm's accounting earnings do not measure the true value of a company (omitting, for example, working capital and capital investments), and only cash flow should be discounted in valuation. The instructor might ask: **Why might CAP have used EPS instead of DCF?**, and **What might the firm's valuation have been under DCF?**

The Discount Rate. After agreeing on projections, students must select a discount rate. The case supplies information suggesting that the appropriate discount rate lies midway between 10 percent and 20-25 percent. CAP actually selected a 16 percent discount rate by splitting these figures. Students should be able to see how the firm arrived at its per-share issue price of $0.25 in both 1981 and 1984. The instructor might ask: **How did CAP arrive at 16 percent? Do you agree with this discount rate, or would you choose another?**

The instructor can explore several different issues. First, while CAP's discount rate should be the firm's opportunity cost of capital, the firm is raising equity (not debt) capital. Second, the instructor should point out that CAP is a holding company raising funds for investment projects of two principal subsidiaries engaged in very different activities. The cost of equity capital used in evaluating investments for any subsidiary should reflect the risk associated with the industry in which that subsidiary operates. As described below, CAP's analysis should therefore center on an average cost of capital weighted by the different activities of the firm's subsidiaries (WACC).
Discussion should focus on measuring the riskiness of CAP's cash flow projections. As CAP is the country's only major steel and minerals producer, in-country industry comparisons are not possible. The case supplies not information on cross-country ratio analysis comparisons. Another approach is to break down the different components of risk premiums, and work with the students to attach values. A possible risk premium breakdown could include: the riskfree rate (long-term government bonds); market (or business) risk; and financial risk (the firm's leverage). The instructor could perform basic sensitivity analysis to show that a range of values could have been considered for CAP's shares (perhaps, as mentioned below, for different shareholders).

The Stock Exchange. Case Exhibit 9 provides monthly share prices in pesos over the previous two years. Dividing the fourth column by the first, the exhibit shows the calculations necessary to adjust peso prices for exchange rate changes, and shows that in June, 1985, the U.S. dollar per-share price was $0.21, or 4 cents under the per-share valuation price

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arrived at in early 1981. Note also that when CAP's valuation was completed (November, 1984), the firm's market price was $0.10 per share.

Here the instructor could elicit discussion not only on the discrepancy between CAP's offer price of $0.25 and the market's judgment of $0.21, but also on the validity of the stock market as a method of valuation. Although financial theory stresses that an efficient market will have thoroughly analyzed all information publicly available about a firm before rendering its pricing judgment, the case suggests there is reason to doubt this judgment. Given depressed economic conditions, and the fact that CAP's shares were not heavily traded during or before 1985 (from 1970-1985 they were virtually not traded at all), the instructor might ask: **Could the market's verdict be incorrect, perhaps undervaluing the firm because of a lack of information or failure to fully appreciate the firm's potential as envisioned by De Andraca?**

Liquidation was not a viable option in this case for two principal reasons: 1) the government believed that decisions to sell off assets belonged to the private sector, and 2) CAP recognized that selling off its worst-performing subsidiary, CMP, was extremely difficult given its high level of indebtedness. Book value could be explored by the instructor, but was not considered useful by CAP management or the government.

3. Workers' share purchase. CAP management turned to their workers after all other options had been explored. Appendix 3 show potential shareholders considered and approached. Case discussion of the worker share purchase should stress that management and leadership skills were critical to making such a program viable. Here, the instructor should highlight that strong employee-management relationships, the charismatic personality of Roberto de Andraca, and management's effective communication of an inspiring vision of the company's future were key elements in managing this process successfully. CAP's record of an average employee turnover of 21 years underscores that conditions were favorable for such a program, and suggests caution about "generalizability."

Discussion should also focus on assessing the costs to the firm of the financing package. The two main financial costs to CAP of De Andraca's loan program included the opportunity cost of lending the workers' money at zero real interest, and the cost of insurance against downside risk. Students should make back-of-the-envelope calculations of the interest opportunity costs of lending 15, 20 and 25 percent of the value of total authorized and paid-in shares, at the 11 percent real interest rate prevailing in the marketplace in 1985-87. As shown in case Exhibit 3, total authorized and paid-in capital was $568,565,652. Appendix 4 provides a rudimentary method of assessing opportunity cost in interest. The appendix amortizes the loan over 16 semi-annual installments and calculates simple (not compounded) interest on the outstanding loan balance.

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These calculations should be what De Andraca will present to his top executives and the board the next day. To assess their relative magnitude--and thus "affordability"--the student should refer back to the consolidated income statements (Case Exhibit 6), and the projections of income laid out in Case Exhibit 8. Although the general conclusion is that with annual consolidated earnings estimated at $9.320 million for 1985, interest costs around $1-2 million are "affordable", Appendix 4 (cont'd.) shows that these added costs amount to a $0.12 surcharge to CAP per share.

These costs, however, should be weighed against a general magnitude of the benefits (both financial and non-financial) from marketing the shares to workers and accelerating CAP's privatization. Note that the case hints at important potential employee-management benefits including higher worker productivity, reduced pressure for strikes, and stronger worker loyalty to the company. To varying degrees, all of these benefits actually materialized and were cited by management as very valuable aspects of the firm's privatization.

Finally, the insurance scheme could, in the worst-case scenario (i.e., CAP's bankruptcy), cost $0.25 times the number of shares sold to workers. Of course, reaching a more precise estimate would entail estimating the probability of share depreciation. The case supplies no specific information on this point. The instructor could, however, raise an interesting question: **Who bears the risk in this insurance scheme -- the company, or the government?** The instructor might also revisit this question in closing the case (see below).

4. Share repurchase. This option should stimulate students to think creatively about managing the privatization process. Analysis should focus on discovering that CAP had sufficient cash reserves at the Central Bank to do the deal. CAP's consolidated balance sheets (Case Exhibit 5) show the firm's time deposits were estimated at $187,957,000 in 1985. The case states that 95 percent of these deposits, or $178,559,150, were held at the Central Bank. As Appendix 4 (cont'd.) shows, CAP had well over double the funds necessary to make such a purchase. The instructor should point out the somewhat unexpected result that CAP was cash-rich as a consequence of the government's strict limits on investments. The company could not use these funds for any other purpose since 1979, and tapping the deposits was a no-lose proposition for CAP's management. In addition, students should recognize that though unorthodox, this move offered a considerable amount of money to the cash-strapped government.

Pricing of the buyback is again a key issue, and should elicit discussion on the consistency of per-share valuation over time and across buyers. This angle presents the instructor with another opportunity to evaluate the $0.25 per-share price. Note the important political and financial differences between buying shares from the government and selling them to workers.

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Should the price be the same? What are the potential disadvantages? Appendix 5 shows the costs to CAP of different ownership/repurchase scenarios.

Finally, students should also recognize the importance of this move in terms of accelerating the share sale process, building a momentum that swiftly brought CORFO's ownership share down to 51%. As Case (B) documents, this move affected the public's expectations about CAP's full privatization--as De Andraca anticipated--and increased investor interest. Equally important, it made De Andraca's job of tipping the firm to majority private ownership significantly easier. It was a shrewd lesson in the management of privatization.

5. Closing. For the closing few minutes of the case discussion, the instructor should quickly review the major elements of the case, and stimulate students to summarize their conclusions about the re-privatization as a whole. Appendices 1-5 can be made into transparencies to help illustrate the case's decision-making focus, rough calculations of costs and benefits, and key lessons learned.

Though not explicitly addressed in the case, issues related to capital market development and the government's macro priorities should then take center-stage in the closing assessment of the case. Most important, the instructor should ask students to step back and consider several key questions: **Whose money was used to finance this repurchase?**; and, **What was the impact of this buyback on the development of Chile's capital market?** In directing this discussion, note that although the benefits to the government of receiving a cash payment from CAP appeared on the surface to satisfy all parties, for both of the options detailed in the case (worker share purchase and the firm's share repurchase), funds came from CAP itself. In short, CAP purchased its own shares with its own earnings/savings--CAP's partial re-privatization was an employee-management buyout (note that the firm's complete re-privatization involved other private capital).

As usual, there are pros and cons to this type of privatization. On the positive side, students should recognize that if CAP had not been re-privatized, the firm would have eventually been liquidated, probably in a piecemeal fashion. Recall that aside from workers, there were no other willing buyers at $0.25 per share. CAP's liquidation would likely have resulted in less revenue for the government, the loss of roughly 7,000 jobs, and a reversal of Chile's efforts to cut its dependency on imports of steel products. Time pressure was high, decisions had to be made quickly, and allowing the firm to sink into obsolescence would not have served any actor's interests. For the company, re-privatization meant access to fresh capital, and freedom to update production, expand and diversify. For the government, CAP's re-privatization meant a large receipt of much-needed cash and the advancement of its flagging privatization program.

On the con side, CAP's share repurchase was problematic because it conflicted with other government privatization objectives. As an SOE, the funds CAP utilized to re-privatize actually belonged to the government. Moreover, by subsequently annulling the shares repurchased with these funds, the firm not only reduced its own equity capital, but also constricted share ownership. Note that wider share ownership was a central goal in the government's post-1985 privatization program. Case (B) expands on this issue.

V. Case B

Case (B) can be utilized in one of two ways: the instructor can highlight the key points listed in Case (B), and then distribute it to the class, or the instructor can hand out Case (B), ask students to prepare discussion questions, and lead a second discussion the next day. Some questions raised by CAP's post-privatization experience include:

1. How do we evaluate CAP's earnings projections now? What about the firm's choice of a discount rate?
2. How do we feel about the prices at which CAP sold its shares to workers and repurchased its shares?
3. Where did CAP make significant efficiency gains (in operational costs, or financial)?
4. Are these privatization/ownership issues?
5. Are there any regulatory concerns in CAP's broad diversification?

VI. Case (C) and Epilogue

Case (C) and the Epilogue are best utilized as a continuation of Cases (A) and (B). Now that CAP has been privatized and is operating in the free market, the issues raised are less concerned with themes of privatization and, consequently, the case focuses on a more traditional investment evaluation and issues of corporate strategy. The Epilogue should ideally be distributed after students have had an opportunity to analyze the options presented in Case (C), considering issues such as those presented in the discussion questions below.

Discussion could begin by having students determine whether, as investors, they would buy, sell, or hold their shares of CAP in November 1994, before the announcement of the reorganization. From here, the discussion may revolve around the major themes listed below, perhaps with some prompting by the case leader.

NOTE: Case (C) and the Epilogue were researched and written less than one month after the reorganization was announced. As such, data regarding the investor response to the restructuring and the performance of each of the three new entities was unavailable.

The decision to reorganize (Case C)

1. Review financial statements of CAP Consolidated and its main subsidiaries. Analyze the structure of the holding company, the profit breakdowns and asset distribution.
2. Apply the standard ratios for analysis, using the template provided as Exercise 1, to discern the company's profitability, growth, liquidity and management success.
3. Why do you think CAP was selling at only 1:1 price to book?
4. How would you evaluate the various options that De Andraca must consider (restructuring, selling the Swiss shares on the local market, private placement, and listing as an ADR)?

The reorganized company (Epilogue)

1. Based on the balance sheets and the information provided in the epilogue, what are the prospects for each of the three new entities?
2. Are capital increases for each new company necessary? At what level?
3. What is the strategic value of the CAP-affiliated steel distributing and import companies in the Invercap group?
4. What important issues must be addressed by CAP S.A.? For Terranova? For Invercap?

Student Viewpoints

1. Was the reorganization of CAP a good plan from the standpoint of corporate strategy?
2. Are the returns on investment of each company satisfactory to investors?
3. If you were a CAP investor, what would your reaction be to the reorganization? What would you do with the shares you hold in each of the three companies?
4. What are the advantages of an ADR listing for Chilean companies? Any disadvantages? Should all three companies obtain listings?
5. Is there any impropriety in a former CORFO official, Hernán Buchi, accepting the post of CAP director and possibly the presidency of Terranova?

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I. Introduction

Privatization in Chile took place in two stages which were closely linked to two different phases of Chilean economic development. The First Round--which began shortly before a serious recession in 1975 and concluded just prior to an even deeper recession in 1982-1983 coincided with a period of sweeping institutional changes and a major effort to restore macroeconomic balances and stabilize the economy. During the two years of recession which followed the First Round, approximately 50 major companies that had been privatized in the first phase once again came under government control due to massive disruption in the financial sector. The Second Round began in 1984, following the re-privatization of these firms, and ended with the election of a new president in 1990. This stage took place during a period of economic recovery and adjustment, which continued through the mid 1990s.

The privatization program was part of a major program of institutional reforms undertaken by the military regime of General Augusto Pinochet shortly after President Salvador Allende was deposed in a violent military coup on September 11, 1973. The new military government believed that institutional restructuring was vital if its objectives of economic growth, full employment, and the elimination of extreme poverty were to be achieved. Furthermore, it believed that economic decentralization was necessary for efficient, democratic organization. The regime therefore favored individual rights, such as the recognition of private property, and favored market economics. In this sense, privatization was consistent with the regime's political and economic goals, and it was strongly promoted from 1974 onward.

This surprised many who thought the military would have favored a more centrally directed system, given their own hierarchical organization. However, given the extreme disarray of the economy inherited from Allende--with 39% of Chile's GDP controlled by the public sector, subsidies to state-owned enterprises (SOEs) in excess of $500 million per year, fiscal deficits in excess of 20%, and inflation at nearly 1000%--the new government had to consider major structural changes. It therefore took immediate steps to reverse the central economic policies of the socialist Allende government.

II. Key Actors

Key actors in Chile's privatization program were the president, General Pinochet, and the Corporación de Fomento de la Producción (CORFO). Initially created in 1939 as a state development corporation, CORFO's original mission was to promote productive activities through private sectors loans, guarantees, and, occasionally, direct investment in projects. It grew modestly in the post-War period, holding equity in 46 companies by late 1970. Under Allende, however, CORFO became the state arm for nationalization. By the end of 1973 it owned 500 SOEs, including 19 commercial banks. In 1974, the Pinochet government designated CORFO as the agency responsible for implementing Chile's privatization program.

CORFO created an Enterprise Management Unit to assist in directing the development and management of firms in its portfolio, initiate diagnostic studies to prepare for privatization, and negotiate the transfer of its property to the private sector.

Also vital to the success of the program, particularly in the First Round, were the so-called Chicago Boys, a group of liberal economists trained at the University of Chicago. The Chicago Boys served as key advisors to the Pinochet government and were instrumental in developing the ideological approach to the privatization program in general. They favored a radical shift away from the protectionist and interventionist policies of the country, to move towards a market economy in which economic agents were stripped of monopolistic powers. The breakup of monopoly power was to affect both enterprises and unions.

Another dominant figure in the privatization program was Hernán Buchi, a dynamic young economist firmly committed to free market principles. Buchi became Minister of Finance and director of CORFO in 1985. As Minister of Finance, he was the most powerful official in CORFO, and his commitment to privatization gave the program renewed momentum in the Second Round.

III. Objectives

Initial objectives of the Pinochet government in the first round of privatization were varied. One initial objective was to establish a viable democracy, using privatization as an instrument to decentralize and expand economic power in the country. Another primary objective was the reduction of fiscal deficits.

At the time of the takeover, the new government was faced with a national deficit in excess of 20% of the GDP. This was the economic impact of the Allende administration's attempt to implement its political agenda through income redistribution and extensive state control of the means of production. These policies led to broad subsidies, sizable expansion of public employment, and expropriation and nationalization of private companies. Since tax revenues were insufficient to finance these activities, the government financed its fiscal deficits through central bank credits. This resulted in rampant inflation and subsequent price controls. In August, 1973, official inflation was an unprecedented 300 percent. Two months later, it had increased to nearly 1,000 percent.

To address this disequilibrium, the Pinochet government sought new programs to secure a high and stable rate of economic growth, eradicate extreme poverty, achieve full employment through productive activities, and achieve price stability. Control of inflation and deficit financing by the central bank were fundamental objectives, as was the increased efficiency, as measured by profits, of both public and private enterprises. Major objectives of the first stage privatization program, therefore, were to return control of state-owned enterprises to their legitimate owners and reduce fiscal deficits.

In the second round of privatization, a principal goal of the government was the elimination of SOE deficits, the removal of the government as contingent guarantor of the indebtedness of state-owned entities, and further decentralization of economic power. The re-privatization, or normalization, of those firms taken over by the state (sometimes called the odd sector) during the severe depression of the early 1980s was another important objective. Additional objectives in the second stage included the generation of public funds to finance social and capital expenditures, the strengthening of capital markets by broadening stock ownership, and shifting the overall development strategy to a market orientation. The government also pursued political objectives along with its economic goals.

In some instances, objectives for the second round changed mid-stream. For example, CORFO would announce that a certain percentage (i.e. 30%) of an SOE's shares would be offered to the public; later, however, it announced that 100% of the shares would be divested. One possible explanation for this perceived misrepresentation of intent was that the capital market in Chile was of limited size and the government was concerned that it might not have been able to absorb a large share offering at one time. Another possible explanation was that the government was not initially committed to a program of 100% privatization of certain SOEs, particularly those which were thought to be of strategic national interest.

IV. Privatization Techniques

A. First Round (1974-1981)

Immediately following the takeover in September 1973, the Pinochet government appointed representatives in every state-controlled enterprise in order to normalize their operations. The primary focus was on those firms which had been taken over by the Allende administration for little, or no, compensation to the original owners. During 1974, 325 state-managed enterprises, with a net book value of approximately US$1 billion, were returned to their owners on the condition that they would formally agree not to litigate against the state. [1] In some cases, additional conditions were imposed to ensure maintenance of employment levels, competitiveness among related industries, and level of new investments. To expedite the process, CORFO's Enterprise Management Unit assisted the new owners with their

[1]Hachette and Lüders, op. cit., p. 46.

development plans. An interest rate subsidy was also granted to help the companies get started under new management.

Several privatization modalities were utilized for direct divestiture of the SOEs between 1974 and 1981. Enterprises were liquidated, with their operations shut down and their assets auctioned, if the government expected they would incur losses even with efficient management. Liquidation of assets also occurred in cases where the highest bid for an SOE was less than the value of its assets. Accurate valuations of these companies were difficult because of the protectionist economic environment at the time, which included subsidies, customs duties, and regulated prices. As a result, the value of going concerns might be well below the value of its assets, thus liquidation was the rational choice. In the case of smaller SOEs, direct sales were sometimes the mode of privatization.

A significant amount of land was also privatized during the first round. Of the total taken over by the Agrarian Reform Corporation (CORA) under Allende, 28% was returned to the former owners. Another 52% had been divided into 52,603 smaller plots, which were economic units to provide for family living expenses and repayment of the land. These were sold at subsidized prices and on favorable terms to former workers on the farms. A point system, based on such factors as age and family size, was used to determine eligibility.

The most common divestiture method during the first round was bidding at auction. Detailed information on the SOE and the auction conditions was offered for a fee to interested bidders. Terms were either cash or installments, but all terms and conditions were negotiable. The seller, or CORFO, reserved the right to refuse any bid. Negotiations often continued with the two top bidders, which sometimes encouraged lower initial bids and might have resulted in lower final sale prices.

The primary objective of this modality was to maximize the sale price of public sector assets. Therefore, controlling packages--generally representing all the shares held by the state--were usually sold. In order to broaden ownership, the government initially stipulated that no single investor could purchase more than 1.5% of any financial institution or 3% of any corporation. This was later repealed, primarily because it was thought that higher prices could be obtained if controlling interest was offered as a package.

Because of limited capital resources in the country, the small size of the private sector, the unequal distribution of wealth, and the unfavorable foreign investment climate at the time, institutions had to be sold in installments instead of for cash. This led to an unusual pattern of enterprise ownership in Chile following divestiture, characterized by the formation of "financial" groups that controlled a significant proportion of the country's largest enterprises. These highly leveraged conglomerates were formed with a relatively small capital base and expanded rapidly on credit.

The formation of these institutions was relatively easy. When a public-sector financial institution was offered for sale, an individual or a holding company could make a small down payment, financing the balance with either direct credit offered as a part of the divestiture process itself or with credit granted by the divested financial institution. The credit was guaranteed, at least partly, by the shares being acquired.

As a financial institution's share prices increased, the same group could utilize their capital gains to purchase shares in a new entity being privatized. The investors would finance the required down payment with profits made by operating the financial institution previously acquired, or from other enterprises they owned; frequently, however, these resources were complemented by new credit granted to the holding company by the financial sector. As before, the credit was guaranteed by shares--both those being purchased, and those in the financial institution(s) already owned by the investment group.

This process, referred to as asset monetization, functions well when the prices of assets are relatively high and rising; however, when share prices decline, the value of the collateral decreases accordingly. Chileans became painfully aware of the downside of asset monetization in 1980-82, when a sharp decline in share prices resulted in a collapse of ownership networks among financial groups and some of the largest privatized enterprises. As a result, the government intervened in sixteen financial institutions, including those belonging to Chile's two largest financial groups, and regained public control of approximately 50 enterprises shortly after the first round of privatization.

B. Second Round (1984-1990)

The second round of privatization began in 1984 with the re-privatization of the companies taken over by the government during the financial crisis described above. These firms, known as the "odd sector," included around 50 of the country's largest industries, insurance companies, mutual fund administrators, private pension funds (AFPs), trading companies, and other entities. In addition to the privatization of the odd sector in 1984-1985, the second round also included the privatization of a small number of traditional SOEs, including large public service and infrastructure companies.

Techniques utilized in the privatization of the odd sector reflected a shift in the government's objectives for the program in light of recent experience. Distribution of ownership became a higher priority than maximizing revenues. The government was willing to forego some potential revenues in order to reduce the risk that a privatization would be reversed. A variety of modes was used during this period, sometimes even in the divestiture of a single firm.

A number of modalities were utilized during the second round, and in some cases several techniques were used for the privatization of a single company. As in the first round, the productive companies odd sector were for the most part auctioned off, with controlling stock offered as a package. However, no credit was granted and bidders were required to demonstrate solvency. As local investors were typically undercapitalized and foreign investors had shown a growing interest in Chile, a number of the larger re-privatized companies were acquired as joint ventures of local and foreign investors. For example, the Petroleum Company of Chile (COPEC) was acquired by a large Chilean firm that immediately sold a 50% equity stake to a New Zealand investor. The United Breweries Company (CCU) was jointly acquired by a local conglomerate and one of the largest German beer producers. The government welcomed this foreign participation, viewing it as a means of avoiding the excessive private-sector indebtedness that had resulted during the first round of privatization. As an added incentive, foreign investors to were allowed to pay for their shares with Chilean foreign debt, which could be purchased on the secondary market at a substantial discount.

The large financial institutions of the odd sector, including the country's two largest commercial banks (Banco de Chile and Banco de Santiago) and the largest private AFPs (Provida and Santa Maria), were re-privatized through "popular capitalism." Under this scheme, the government offered new shares to the general public, with an automatic long term credit at zero interest and an extremely generous investment tax credit. A special law permitted CORFO to lend up to $32,000 to small shareholders. These favorable investment conditions, combined with a limit to the number of shares each person could buy in any one company (approximately $5,000 per person) were designed to spread ownership of these shares as widely as possible. The program, which ended in 1986 (some three years earlier than the period established by law), created approximately 47,000 new shareholders.

Popular capitalism was used to finance 70% of the equity of the two banks, 60% of the sale of the AFP Provida, and approximately 49% of Santa Maria. To provide for efficient management of the AFPs, control of their remaining stock was offered to two U.S. financial institutions.

The latter half of the second round of privatization in Chile entailed the privatization of most of the large, "traditional" SOEs created or nationalized by law--including the electric company, the telephone companies, other large utilities, the railway, and steel companies. Total revenues from these transactions were in excess of US$1.2 billion.

The privatization of these enterprises was generally not favored and was therefore politically more sensitive; in fact, traditional SOE's had not been included in the government's original divestiture plans. In order to gradually build public support, the government chose to divest each of these companies on a step-by-step basis. It therefore used a number of modes simultaneously, offering shares to workers, to pension funds, and to other investors, taking care to achieve a wide distribution of the shares. To accomplish this, the government typically enacted legislation to transform the SOE into a corporation so that its shares could be traded on the stock exchange and its accounts and operations would be subject to audits by the Superintendency of Securities and Insurance. The government would then announce the privatization of a portion of the company's equity, perhaps 30%, utilizing one or two modalities. When that percentage was successfully divested, the government would announce the privatization of another 19 percent, possibly using a third divestiture mode. Up to that point, the company still remained under public control. The subsequent announcement of an additional 2% would transfer control to the private sector. Privatization of the remaining stock--sometimes up to 100%--was subsequently accomplished through small- to medium-size share offerings in the Santiago Stock Exchange.

The main divestiture modes utilized during this final stage were labor capitalism (sale of SOE shares directly to workers of the enterprise being divested or, in cases such as the National Electricity Company, ENDESA, to public servants in general); institutional capitalism (sale of SOE stock to institutional investors, particularly the private pension funds); traditional capitalism (sale of shares through the stock exchange or public bidding); and, in some cases, popular capitalism.

Finance Ministry officials stated that 20 to 30 percent of the privatized companies were purchased by workers. Employee ownership of the nitrates producer, SOQUIMISH, reached 99 percent at one point. The steel and mining company, CAP, also had a high percentage of employee and executive ownership, which reached about 41% in 1991, according to union leaders at the company. In addition, CAP offered loans at zero interest to workers and executives based on salary and number of years with the company, using their individual retirement funds as collateral. The electric company, ENDESA, sold 30 percent of its shares to the public in 1987. The sale was initiated with a preferential offering to 4,000 ENDESA workers, who had three months to decide on the purchase.

V. Accomplishments To Date

In the first round, the government returned almost all state-managed firms to their legitimate owners and privatized all non-traditional SOEs. Between late 1973 and 1980, the number of public enterprises was reduced from 596 to 48, with only two new SOEs being created. All state-owned banks, with the exception of Banco del Estado and one with legal problems, were transferred to the private sector. Large portions of agricultural land were also returned to their former owners.

Although there was steep opposition to the privatization of "traditional" SOEs, most of these enterprises were divested in the second round, and their privatization is now accepted by the public. Only the national copper company, CODELCO, and the state petroleum company, ENAP, remained in the public sector after 1990. (The Chilean Constitution prohibits the privatization of these companies.)

In general, the privatization process was successful in distributing property to a much wider ownership base than had been the case before 1974. The program stimulated both the public and private sector to improve efficiency. It opened new investment opportunities and created new responsibilities for the private sector, and it contributed to markets replacing central direction as the driving force of the economy. The program also helped reduce practical and psychological dependency on the large SOEs.

Social security and pension fund reform, which was established by decree, was one of the most important social reforms undertaken by the government. Under the old system, workers, employers, and the state paid into a common fund, which was administered by the state. Benefits varied widely, depending upon economic sectors, power of unions, and employee organizations. Avoidance of payments and other forms of evasion and fraud were commonplace. Under the new plan, management of the social security system was shifted to private pension funds, known as AFPs. Employer contributions were eliminated, and state administration was reduced. The new plan, which represented a radical departure, saw 75% of the workforce join voluntarily within the first year. Moreover, the privatization of the system contributed directly to the growth of the capital markets in Chile.

V. Results/Impact of the Privatization Program

A. Impact on Employees

In the divestiture of public enterprises to the private sector, employment nearly always declines. The operating objectives of state-owned companies often differ from those in the private sector, which usually have profitability as their primary goal. Many public companies must also take into account such factors as the government's social objectives. As a function of political favors or the government's desire to reduce unemployment in general, these companies frequently have more employees than are necessary, making it difficult to operate the business profitably.

Privatization in and of itself does not seem to have had a negative effect on employment in Chile. Between 1973 and 1982, employment in SOEs decreased dramatically, from 161,000 (5.6% of the workforce) to less than 90,000 (3.2% of the workforce). However, only a fraction of this reduction can be attributed to privatization. The most important factor was the government's emphasis on increased public sector efficiency, which was to be measured by increased profits. As in the private sector, many SOEs met this objective by reducing their workforce. In the second round of privatization, employment levels at many privatized companies actually increased as their markets expanded.

B. Impact on Government

Studies suggest that privatization will enhance government finances only if the privatized firms operate more efficiently in the private sector than they had in the public sector, assuming the SOEs were divested at a fair price. Revenues tend to diminish if the sales proceeds are invested in non-revenue producing projects or are consumed by other public expenditures.

In the short run, divestiture did decrease government revenues in Chile. In the first round, privatization revenues were depleted by the government's social programs. In the second round, they were invested in non-revenue-generating public works. Since the privatized SOEs no longer generated revenues for the government except in the form of taxes, it was a net loss. If, however, the SOEs had operated at large deficits which required subsidies from the central budget, the impact on government revenues was less clear.

Divestiture modes were selected to maximize public sector revenues. At the time of the military takeover, central government expenditures had reached about 50% of GDP, only half of which was financed through taxes and other income. The new government expected to reduce the deficit to 25% of GDP by a) raising tariffs of utilities and forcing the SOEs in the sector to become self-financing; b) instituting tax reform to increase tax revenues to 5-6% of GDP; and c) using revenue from privatization. Aside from possibly contributing to deficit reduction, the argument can be made that privatization provided a source of income for social expenditures and public works that would not otherwise have been available at the time.

SOEs in Chile were obliged to distribute a high percentage of their profits to the state in dividends. In the 1980s, dividends were normally 100% of profits, and new investments were allowed only after careful evaluation. Although a few small SOEs were still showing losses during the 1980s, most SOEs had turned their significant losses into profits. Following privatization, the companies were free to determine the level of their dividend payments, furthermore, the government only received dividends from those companies in which it had retained an equity stake.

C. Impact of Privatization on the Competitive Environment in Chile

In general, privatization had a beneficial effect on competition in Chile. This was due to the fact that privatization took place within the context of a sweeping program of economic liberalization. The country's economy was opened to imports, with only a small duty and value-added tax, which invited new and important competition from foreign producers. Following the elimination of most foreign trade restrictions in 1973-1974, Chile experienced a surge in international commerce. Tariffs--which had previously ranged from 0 to 750%--were revised to a single flat rate of 10% between 1974 and 1979. A more realistic foreign exchange rate was implemented at the same time.

Between 1973 and 1981, the export sector increased at a rate of 13.2%. New and more diversified markets were developed by Chilean producers. The most dramatic evidence of this shift is the fact that copper, which had represented 82% of Chile's total exports in 1973, accounted for only about 49% of exports in 1981.

D. Impact of Privatization on CAP: Competitors, Suppliers, and Customers

CAP's steel operations had few domestic competitors following privatization. Its major competitors were from Brazil, which had a huge steel industry. New competition also came from Argentina, Venezuela, and Mexico--all of which have sizable steel operations. CAP partially reduced the competition from Argentina, however, by making an equity investment in Somisa, an Argentine steel company.

Suppliers of raw materials saw increased business from CAP, even before privatization. Improvements in the operating efficiency of the Huachipato steel plant led to increased procurement from suppliers of coal and tin. The plant's managers brought in consulting teams from a Japanese steel company shortly after the first round of privatization, but before CAP itself was privatized. At that time, the SOEs had been ordered to operate more efficiently and were informed that they could not expect subsidies from the government. In addition to the improved efficiency, some new suppliers were able to make competitive supplier bids as a result of the new open economy.

The effect of privatization and economic liberalization on customers of CAP was important. For the first time in many years, builders and other heavy users of steel products could receive serious competitive bids from suppliers outside of Chile. In 1992, more than half the steel consumed in Chile came from sources outside the country. The government's reform program, including privatization, resulted in lower prices and better service for steel buyers in the country.

E. Impact on Corporate Governance Structures

Economic efficiency, in the sense of sustaining subsidy-free profits for both public and private enterprises, was continuously emphasized by the government. This resulted in a new approach to corporate governance on the part of the SOEs as well as privatized entities. A new business environment developed slowly during the 1970s and early 1980s, in which: a) all enterprises were subject to either strong competition or special regulations based on marginal cost pricing that would disallow monopoly profits and inefficiency; b) public enterprises were obliged to become self-financing with no further subsidies and were allowed to charge market rates for their products; and c) the government stopped intervening in SOE management. Boards of directors immediately began operating on a much less political basis than had previously been the case.

In addition, through the privatization program, many workers became shareholders in major companies. Through the private pension funds, workers also came to participate indirectly in the ownership and control of a number of large privatized traditional SOEs. In several of these entities, particularly the main public utilities, the board of directors is majority controlled by worker representatives, and in some others workers have significant representation on the board. Since most of these worker representatives are highly qualified professionals committed to maximizing financial returns for the enterprises they direct, to date there have been few conflicts between their roles as workers and as capitalists. The economic recovery of the late 1980s has facilitated this, as it has brought with it significant capital gains and high rates of return on initial investments. It remains to be seen how these worker/directors will respond when macroeconomic conditions change.

F. Impact on Capital Markets

Privatization had a dramatic effect on the development and character of the capital market in Chile. First, the privatization of the banks and industrial concerns paralleled the deepening and broadening of the market. Total financial liabilities increased from 5.9% of GDP in 1973 to 54% in 1981. Stock transactions in financial and non-financial institutions increased nearly tenfold during the same period. The General Index of Share Prices rose about six-fold between 1977 and 1980; this growth was supported indirectly by the privatization process.

Savings and investments grew as the result of a more stable business environment, a more efficient capital market, a well defined private sector, and a foreign investment code attractive to offshore investors. Additionally, and most importantly, interest rates were deregulated, credit controls were significantly changed, and barriers to entry in the banking system were reduced, all of which dramatically improved the financial environment for both individuals and corporations.

The social security system was also privatized during this period. While Chile was ahead of most of the world, and all countries in the Western Hemisphere, when it established a social security system in 1924, the system had always been managed by the state. By the late 1970s, social security expenditures began to exceed revenues. In addition, the social security system was aggravated in the 1970s by substantial inefficiencies, which had become commonplace, as well as an aging population base. In 1981, the management of the system was transferred to private investment funds. As a result, individuals were able to determine how their retirement accounts were to be invested. This contributed significantly to the expansion of the Chilean capital markets in the 1980s.

VI. Lessons Learned

A. Managing the Implementation Process

The government learned much from the first phase of privatization and subsequently revised the process to include new modes of divestiture in the second round in 1985. The Chilean program demonstrated that broad and widely-diversified privatization can be successful in a developing country as well as an industrialized country, such as England. Moreover, it does not require any unique resources, since divestiture can take place in many different ways, including transfer of ownership without financial compensation to the state. The government learned that successful privatization can be accomplished in almost any sector of the economy, provided that an effective policy and implementation framework is in place. The social security system was probably the most notable example of innovative privatization in Chile, but SOEs in the health and education sectors were also privatized.

The privatization process in Chile suggests that strong leadership enhances the probability of success, as does the use a variety of divestiture methods designed to enlist the support of as many interested parties as possible. Groups deeply interested in the transaction would include, at a minimum, the workers, management, potential shareholders, suppliers, competitors, customers, the military, and the government. Effective communication with all of these stakeholders of the benefits and downside risks of privatization are vital to the success of the project.

The government also learned that block sales of companies on credit terms to controlling shareholders should be avoided. Sales to foreign investors can be made in such a fashion as to limit their potential domination of economic sectors. Through specific divestiture programs, sales of enterprises to foreign investors also can serve other important objectives, such as reduction of international debt obligations and enhancement of local capital markets.

As previously mentioned, it appears that privatization does not in itself have a negative impact on employment levels; rather, employment is affected by the process of increasing the operating efficiency of a company, regardless of whether the company is in the private or the public sector.

B. Managing the Expectations (Politics)

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Privatization seems to have played an important role in granting the government the power it found necessary to keep public order and at the same time implement structural reforms. In one sense, citizens of Chile had been exposed to a wide range of political and economic programs in a relatively short time, including those of the Christian Democrats under Eduardo Frei in the late 1960s and the Marxist government of Salvador Allende in the early 1970s. None of these programs had been successful prior to the military takeover by Pinochet in 1973.

In the first round, managing the political expectations was not difficult, since the majority of the companies and farms which had been expropriated by prior administrations were returned to their former owners. A number of relatively minor problems were encountered, such as loss of working capital and deterioration of assets; these were addressed directly by the government. In fact, some observers were of the opinion that inattentive accounting on the part of the government resulted in overcompensation for these problems. The government did have to manage the change from the SOEs' total dependence on the federal budget to more efficient, market-based operations. It did so by allowing market prices to be established and by maintaining a hands-off approach toward the SOEs' operations.

The second round of privatization, however, brought with it an interesting problem when the government decided to privatize the "traditional" SOEs, which had been protected from privatization in the first round. Chileans were quite accustomed to having basic production elements, and many services, provided by the state. The prospect of these entities being managed by the private sector was extremely controversial. Initial debate concerning the privatization of these SOEs found opposition coming from such diverse groups as the military, Marxists, Christian Democrats, and even some members of the Nationalist Party. The government reacted by allowing debate while proceeding slowly with the privatization process. For example, in cases such as CAP, the government did not initially announce the total privatization of the company. Instead it sold shares in small blocks, permitting the public to become accustomed to the idea of private ownership over time. This strategy was effective, in that formidable opposition did not materialize to impede these transactions.

Political objectives were also successfully realized through the government's program of popular capitalism, which dispersed economic power among wide sectors of Chilean society. Both workers and management were able to purchase significant amounts of shares in privatized companies. In some cases, this was accomplished through loans against their accumulated retirement funds. In other cases it was accomplished through CORFO. In addition, through the private pension funds, individuals were able to participate in the ownership and control of some of the large privatized SOEs.

C. <u>Legal Institutional Infrastructure</u>

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The role of the state as entrepreneur has been a dominant factor in the Latin countries of Europe, Central, and South America since the 18th century, and continues to an important extent even today. In Chile, steps were taken to ensure that the SOEs' role was either strategic or complementary to the private sector. The state's role, however, changed significantly in the mid 1960s through the creation of companies related to CORFO and others created by special law. By 1965, state corporations accounted for 14.2% of GDP, which was notably higher than the world average (9.4%) or the Western Hemisphere (6.6%).

State entities in Chile can be classified into four groups. One group consisted of firms managed by CORFO, including the telecommunications company ENTEL, the steel company CAP, and the airline LAN, among others. A second group included firms created by law, such as the post office, utilities, TV and radio stations, and the state petroleum company, ENAP. The national copper company, CODELCO, comprised the third group. It was the largest and most important corporation in Chile, and also provided the single largest source of revenue. The fourth group consisted of the Central Bank and Banco del Estado.

The government's list of entities to be privatized in the first round included only those nontraditional SOEs that had been nationalized or acquired by the government under Allende. The initial targets for privatization did not include CODELCO, the Telephone Company of Chile (CTC), the Chilean Electric Company (CHILECTRA), and other large, traditionally public companies and SOEs created either by law or by CORFO. As previously mentioned, the Chilean constitution prohibited the privatization of either CODELCO or ENAP. In the second round, however, most traditional SOEs were eventually privatized, with the notable exception of CODELCO.

D. Addressing Tradeoffs

Information on divestiture can be either widely or selectively disseminated. Similarly, the type of ownership of divested firms can vary with privatization goals and the means of divestiture, such as sales in large or small lots. Shares of divested companies can be sold directly to individual shareholders or companies, or they can be sold widely on the stock exchange. The transfer of public assets can be onerous, entailing obligations that exceed advantages, or unrequited, with payment of less-than-kind.

Between 1974 and 1981, the privatization system was biased in favor of a small group with preferential access to credit which functioned within the framework of a small and inefficient, highly segmented capital market. Divestitures favored previous owners and large conglomerates in a shallow capital market, and information on firms to be privatized was not widely publicized, a factor that hampered greater participation.

This situation was reversed in 1985 during the second round. The government was willing to subsidize share prices to achieve widespread ownership, enabling workers and taxpayers to buy shares of SOEs below market prices. Despite its desire to receive full value for the SOEs, the government determined that widespread share ownership was also an important priority.

In general, the privatization program, combined with the liberalization of economic policies, has resulted in widespread share ownership and a significantly enhanced environment for corporate finance. Prior to the second round of privatization, and particularly following the financial crisis of 1981, the local capital market was minuscule. The state was for all intents and purposes the only entity capable of facilitating corporate finance. However, the stable, open economy of the late 1980s and after, combined with the expansion of the domestic capital markets achieved through privatization, brought about significant improvements in the business environment in Chile. Today, any firm in Chile with a capital base, an acceptable track record, and a good business plan can access both local and international capital markets for almost any project.

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