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PII: S0304-405X(14)00017-8
DOI: http://dx.doi.org/10.1016/j.jfineco.2014.01.003
Reference: FINEC2392

To appear in: *Journal of Financial Economics*

Received date: 18 January 2013
Revised date: 3 September 2013
Accepted date: 12 September 2013

Cite this article as: David Buchuk, Borja Larrain, Francisco Muñoz, Francisco Urzúa I., The Internal Capital Markets of Business Groups: Evidence from Intra-Group Loans, *Journal of Financial Economics*, http://dx.doi.org/10.1016/j.jfineco.2014.01.003

The Internal Capital Markets of Business Groups: Evidence from Intra-Group Loans

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Abstract

We study business groups' internal capital markets using a unique data set on intra-group lending in Chile (1990–2009). In line with groups' financing advantage, firms that borrow internally have higher investment, leverage, and return on equity (ROE) than other firms. At the margin, controlling shareholders have higher cash-flow rights in borrowing firms than in lending firms. However, there is no robust evidence of minority shareholders losing out from intra-group loans as tunneling predicts. Our evidence is consistent with the idea that strict regulation and disclosure requirements for intra-group loans, which are features of the Chilean market, reduce the risk of expropriation in pyramids.

JEL classification: G32

Keywords: Business groups; Pyramids; Internal capital markets; Intra-group loans; Cash-flow rights.

Acknowledgements: We are especially grateful to the referee, Tarun Khanna, whose excellent comments substantially improved the paper. We also would like to thank Francisco Gallego, Aníbal Larrain, Tomás Rau, Giorgo Sertsios, Amit Seru (discussant), José Tessada, Vijay Yerramilli, and seminar participants at Tilburg University, PUC-Chile, and the 3rd International Conference of Finance UC for comments and suggestions. We also thank Fernando Lefort and Eduardo Walker for providing some of the data used in this paper. Larrain acknowledges partial financial support from Grupo Security through Finance UC, an independent research center at the Pontificia Universidad Católica de Chile. The views expressed here are not necessarily those of Grupo Security.

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