A TALE OF LOST CHANCES. A SHORT HISTORY OF CORPORATE GOVERNANCE AND OWNERSHIP IN ITALY

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1. Introduction

The literature available in English about the recent evolution of the Italian corporate governance system is relatively scarce. In the main journals dedicated to the corporate governance, a small number of articles deal with the Italian case[1]. Moreover, available research largely focuses on technical aspects[2] and very rarely adopts a dynamic approach to explain the evolution in the framework that in turn shapes the governance practices in use. Articles explicitly using a methodology inspired by history to examine the evolution of the Italian corporate governance system are even rarer[3]. For many reasons, however, the Italian case is worthy of attention. During the last twenty years the country has undergone a number of radical changes, both in the morphology of its industrial apparatus as well as in the institutional framework in which the economic action takes place. These transformations occurred in a framework notoriously characterised by a strong institutional and cultural rigidity. The rules and laws governing corporate behaviour and regulating financial markets dated back to the period preceding the Second World War (and the definitive maturation of the Italian economy during the 1950s and 1960s)[4], and saw little or no changes at all during the second half of the century.

Notwithstanding the changes that have occurred during the last two decades (which will be described in the following paragraphs), a considerable degree of continuity in some structural features (e.g. the persistence of individual/family ownership and control practices as well as of coalitional control; the practice of shareholders' agreements to preserve the influence of major shareholders over the company; the identification between owners and top managers) can still be detected today. When the process of institutional transformation reached its peak at the end of the Nineties, many commentators (and politicians) said the Italian system of governance, ownership and control of large firms was on the verge of a (hopefully) quick process of convergence towards the Anglo-Saxon standards of transparency, protection of minority shareholders, diffused presence of institutional investors able to exert a monitoring role over the management and an increase in the efficiency of the whole system. Apart from these expectations, this process has been occuring at a very slow pace – and according to other observers, has not taken place at all. This article through a dynamic, historical approach reconstructs the process of evolution and change in the institutional framework, and explores the reasons of this limited convergence.

2. Transformations at the turn of the millennium

At the beginning of 2000 the morphology of the Italian top corporations was deeply different from only fifteen years before, even if the country re-affirmed strongly its position among the World's most

[1] For instance, the issues of 2005, 2006 and 2007 of *Corporate Governance: an international review*, *Corporate Governance: the international journal of business in society*, *Corporate Ownership and Control* contain nine articles explicitly addressing the Italian case (plus a special issue in 2007 by this last journal). Out of these articles, only one (Corporate Governance in Italy after the 1998 Reform: What Role for Institutional Investors? by Marcello Bianchi and Luca Enriques. *Corporate Ownership & Control*, Summer 2005, Vol. 2 Issue 4, p11-31) explicitly adopts dynamic perspective, but deals with the issue of institutional investors' activism in Italy.

[2] These cases are of the articles published in the mentioned special issue on Italy by *Corporate Ownership and Control.*

[3],Alexander Aganin and Paolo Volpin., *The History of Corporate Ownership in Italy*. National Bureau; of Economic Research Working Paper 2004

[4] For instance, the revised version of the Commercial Code, regulating among the others the issues regarding corporate behaviour and other governance issues, was issued in 1942 (Codice Vivante). See Raffaele Teti, *Imprese, imprenditori e diritto*, In F. Amatori et. al, (eds) *L'industria*, in *Storia d'Italia, Annali 15*, Einaudi, Torino 1998.

industrialized countries (oscillating between the 7-8th position in the ranking by GNP).

Looking the top corporations, it is impossible not to note the decreased presence of the once dominant State-owned enterprise, due to one of the most intense privatisation processes in world's recent history[5]. Some of the huge state-controlled conglomerates (for instance IRI, a super-holding created during the 1930s) simply disappeared, or reduced considerably their dimension and range of activity. Even if some large, internationally active and State controlled groups (as for instance ENI and Finmeccanica) are still among the largest corporations of the country, it is no longer possible to talk of a system of State ownership in Italy in the form it took from the late Thirties to the end of the Nineties.

Another relevant issue is the transformation that occurred to those companies that were "first movers" in the sectors of the second industrial revolution. These companies started at the beginning of the 20th century in capital-intensive industries and have been able to keep a stable leadership position for almost the whole century. Some of them – e.g. Olivetti (business machines and personal computers), La Rinascente (retailing) and several others – suffered entrepreneurial and managerial failures, quickly losing their dominant position, both in the home and international market. Some others disappeared (for instance Montedison, once the second largest corporation of the country) or transformed *via* mergers and acquisitions (for instance, the case of Pirelli which in 2001 partially changed its business diversifying into telecoms, internet and services after a *de facto* takeover of the Olivetti group). Others have been taken over by foreign capital.

A second relevant point concerns the "relative size" of the Italian top corporations, which has been decreasing over time. The first in the national ranking by turnover was in 2006 the ENI group[6] (with a turnover of about 86 billion Euro), which means, in an international comparison, the 27th position among the World's largest corporations[7]. The size of the 10th (ERG, a family-controlled oil company) drops at 9.1 billion, while the 20th (Supermarkets Italiani, controlled by the Caprotti family) is nearly 5 billion. This smallness of the top corporations is mirrored by the practical absence of the Italian industrial enterprises in the international lists and rankings. According to Fortune, in 2006 there only three Italian financial or non-financial corporations (the Assicurazioni Generali, Eni and Fiat Groups) were present among the first hundred in the world by sales, while the same figure was 10 for Britain, 11 for France, 14 for Germany, to compare only with the main European countries.

Last but not least, the topic of ownership and control. Among the top 50 corporations of the country ranked by turnover, 10 still are State-controlled, 20 are foreign-owned and Italians (individuals, families, shareholders' coalitions) control 20. In the last case these companies are in general characterised by a very concentrated ownership structure (an individual, or family owning the majority of the share capital) or close control by a single shareholder, exerted mostly through devices enhancing the separation between ownership and control rights, such as pyramids. Moreover, according to recent research based upon data referring to 2003 for listed companies[8], the frequency of shareholders' agreements set up in order to increase the control over the firm's capital has been progressively increasing during the 1990s. In 1990, 10.9% of the Italian listed companies were controlled by coalitions of shareholders, a percentage jumping to a considerable 29.2% in 2003[9]. In terms of ownership distribution the main owners of listed companies were (and are today), non-financial companies, individuals, foreign companies (ranked by relevance)[10]. The importance of the State as an owner was still considerable, far more than in the main other European countries. Notably, the mentioned research concludes that little has changed from the early Nineties, when the first studies about the ownership and control of the Italian corporations were carried out, stressing the persistence of concentrated ownership and large private benefits for the main controlling shareholders[11].

3. Italian capitalism from the oil shocks to the end of the Eighties. The first chance

At the beginning of the Eighties Italian capitalism was recovering from a very difficult and problematic period. Big business was seriously damaged by the two oil shocks of the Seventies but, above all, by a transformation of the pattern of development based on low salaries and upon an unprecedented growth in consumption levels. These issues characterized the so-called "Economic Miracle" which lasted nearly fifteen years (1955-1969). As far as the financial system is concerned, the situation was complicated as well. The major corporations could no longer count on abundant internal finance for their needs, nor could they rely heavily upon the financial system, since the banks,

[5] Notwithstanding this, as will be detailed later in the paper, the Italian State still controls some companies in "strategic" industries, mainly in energy and utilities. In some cases it still owns the majority of the share capital of those "Enti Pubblici" (State Agencies) which were transformed into joint stock companies during the Nineties

[6] According to the data published by Mediobanca (see www.mbres.it)

[7] In the Fortune Global 500 ranking. See http://money.cnn.com/magazines/fortune/global500/2007/index.html

[8] Marcello Bianchi et al,, *Proprietà e controllo delle imprese in Italia*, Il Mulino, Bologna 2005

[9] Ibidem, Iab. 4.13, p. 143.

[10] Ibidem, Tab 4.15, p. 146

[11] See Marcello Bianchi et al, *Pyramidal Groups and the Separation Between Ownership and Control in* Italy, in Fabrizio Barca and Marco Becht (eds), *The Control of Corporate Europe*, Oxford UP, 2001.

after the so-called Bank Act (1936), were allowed only to grant short-term credit to the industry. Medium and long-term credit, in Italy issued by the *Istituti di credito speciale* (Special Credit Institutes), the majority of which was State controlled. Different from other successful experiences of a State controlled banking sector backing the needs of the industrial corporations – as for instance the Korean one – the credit issued by these Institutes was largely (even if not only) directed to the needs of State-owned enterprises[12]. The other potential source of finance, the Stock Exchange, was singularly weak. At the beginning of the 1980s only 138 companies were listed at the Milan Stock Exchange, compared with 450 in Germany, 535 in France, 2279 in The United Kingdom. At the same time, the ratio between Stock Exchange capitalization and the GNP in Italy of 5.2 can be compared against respectively 10.6, 6.2 and 43.3. Besides the traditional weakness of the Italian Stock Exchange (a "structural" characteristic of the Italian financial apparatus due mainly to scarce information and low degree of protection for small shareholders), in this period has also to be taken into consideration the competition by Treasury bonds which during the 1970s offered an impressive yield ratio of nearly 20%, a level in practice impossible to obtain from industrial stocks, also in presence of a double-digit inflation rate[13].

The shortage of financial capital is however not a novelty in Italy, a latecomer country which from the beginning saw a pervasive intervention of the Government in capital-intensive industries. Interventionist policies intensified at the beginning of the 1930s, when the German-style banking system was displaced by the crisis and the creation of a huge, direct system of State ownership was necessary to grant the persistence of modern companies in the sectors of the second industrial revolution.

However, nor the State - whose public officials in leadership position in State controlled joint stock companies acted frequently as representatives of the political parties[14] - neither the banking system (which could not by law perform a monitoring role) could ensure an efficient degree of control and protection for minority shareholders.

During the Eighties

This situation started to change considerably during the following decade. The years between 1983 and 1987 saw considerable growth in the Italian financial market. This growth was fostered by favourable general economic conditions, political stability, a restrictive monetary policy that reduced the inflation rate, and above all restructuring of the main industrial groups, obtained through technological improvement, refocusing and internationalization[15]. During the 1980s the Stock Market capitalization increased considerably (from 9.2 in 1980 to 20% in 1989 – with a peak of more than 22% in 1986)[16].

At the same time, this process was accompanied by complimentary changes in the structure of the corporate finance system. The main industrial groups were able to reduce their indebtedness thanks to the restructuring process - strengthened by a positive economic cycle - and in 1983 mutual funds were authorized to operate in Italy. The most evident consequence was on the "stagnant" stock market, the number of companies listed on the Milan Stock Exchange rose from 138 in 1982 to 211 six years later (+52%). The ratio of Stock Exchange capitalization and GNP more than tripled, from 5.2 to 16.3, although the number of listed companies remained relatively small in comparison with that of other advanced economies. This effervescence acted as an incentive for the main industrial groups to collect new resources through the stock market. At the peak of this process, in 1987, the top nine industrial holdings, both private and State-owned accounted for nearly the all of stock market capitalization; IFI-Fiat nearly 30%, the Generali group (insurance) about 19%, Ferruzzi-Montedison (chemicals) 16%, and Olivetti about 10%.

The largest corporations exploited the opportunities of this favourable situation in two ways. The first was to increase the number of subsidiaries listed on the stock exchange - usually one or two financial sub-holdings were listed together with other industrial companies[17]. The second was to directly

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[12] In part, the funds provided by these Istituti di Credito Speciale financed the expansion of some private groups in the chemical industry. These groups received State subsidies and fundings in order to make new investments in depressed areas in order to create new jobs. The result of this policy was instead to increase the inefficiency of the whole industry due to an excess of production capacity. See Fulvio Coltorti "Note sulle modificazioni della struttura finanziaria delle imprese italiane negli ultimi venti anni", in Banca d'Italia (ed.), *Ristrutturazione economica e finanziaria delle imprese*, Rome, Banca d'Italia 1988

[13] By the end of the Seventies, the liabilities of the Italian industrial system were comprised 75.2% by loans from the banking system, 8.3% of bonds and 16.5% of risk capital (stocks). This situation was mirrored by the composition of the private portfolios of individuals, consisting in 84.3% in bank deposits, 14.9% in bonds (above all Treasury bonds) and only 0.8% by stocks. About the inflation rate, which during the Seventies even approached an impressive 20%, see Giovanni Balcet, *L'economia italiana. Evoluzione, problemi, paradossi*, Feltrinelli, Milano 1997.

[14] Franco Amatori *Between State and Market : Italy, the futile search for a third way*, in Pier Angelo Toninelli (ed.) *Rise and Fall of State Owned Enterprise in the Western World*, Cambridge U.P., Cambridge 2000

[15] See Francesco Brioschi et al, *Gruppi di imprese e mercato finanziario*, NIS, Roma 1992; Graziella Fornengo and Francesco Silva (eds.), *Strategie di crescita dei grandi gruppi italiani (1976-1985)*, Angeli, Milano 1993

[16] Source: www.borsaitalia.it

[17] Particularly interesting although not unique is the case of the De Benedetti group. In 1985, to finance expansion (also international) huge resources were necessary and the strategy was to raise the money from the stock market by means of nearly all the listed companies belonging to the

increase the capital of the company through the issue of new shares. In these cases, however, an analysis of the composition of the new issues by share category shows beyond any doubt the prevalence of share typologies with limited voting rights in favour of dividend or cash rights (preferred privileged or "savings" stocks). The result was that at the end of 1988 the shares with limited voting rights represented nearly the 23% of the share capital of the companies listed at the MSE, contrasted with a ratio of little more than 4% less than a decade before[18].

Apart from the increasing relevance of shares with limited-voting rights the increase in the stock market activity brought little to no change in the way in which the companies were governed, or to the way relationships with the shareholders were structured.

By the end of the Eighties, the creation of pyramidal structures made up of holdings and sub-holdings able to gather financial resources in the market (with a very limited loss of control by the main shareholders thanks to the instruments described above) led to a situation in which the main shareholders, usually also inside directors (managers and members of the board), could control their corporation with a very small direct investment of their capital and with a low risk of hostile takeovers. At the beginning of the Nineties, as mentioned above, exhaustive research carried on by the Bank of Italy stressed the persistence, in Italian industrial capitalism, defined the Italian as a model of corporate control based upon pyramidal groups, in general family-controlled, and upon coalitions[19]. In sum, the considerable growth in market finance and in the relevance of institutional investors and above all of the stock exchange was – in this period - not followed by a transformation of the models of ownership and control of the major corporations, nor by the diffusion of the *public company* as an alternative model of control.

The direct outcome of this situation was, as in the past, that the control by the largest shareholders upon the whole group was hardly contestable, with a very scarce degree of protection for minority shareholders. In this framework, the number of hostile takeovers, as can be expected, remained relatively low. Cross-shareholdings, interlockings and alliances among the main industrial groups continued the development of the dense web of mutual relationships that for decades has existed among the largest Italian companies[20].

One of the main proponents of this strategy was Mediobanca, a merchant bank founded at the end of World War II, formally controlled by the three (at that time) largest banks of the country (Banca Commerciale Italiana, Credito Italiano and Banco di Roma). It was *de facto* autonomous and under the strong leadership of a very talented banker, Enrico Cuccia. From the Seventies onwards, Mediobanca progressively put itself in the centre of a cross shareholdings network and shareholder agreements among the main industrial groups of the country. The final result was that the largest groups of the country aggregated themselves around the influential financial institution. The bank acted not only as a consultant and as a reliable merchant bank, in charge of the allocation of bonds and shares in the market, but it also set up - and authoritatively managed - a protective system of cross shareholdings, as in a giant Japanese-style *keiretsu*. Mediobanca also played a relevant role of supervision of the potential asymmetric relationship between minority and majority shareholders – managers. In several cases it was in fact the bank itself that managed the turnover of the top executives (even when they were the controlling shareowners) in the case of inadequacy or mismanagement. To some extent, it is correct to say that for a long period a large proportion of potential and real agency conflicts among large and minority shareholders were limited thanks to the presence of this peculiar "watchdog" whose authority was for a long period not easily possible to question[21].

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group. At the end of the process in 1987, the structure of the group was made up by a very complex pyramid, at the top of which was a holding, COFIDE, listed but directly controlled (47% of the capital) by Carlo De Benedetti. COFIDE controlled (with nearly 35% of its shares) CIR, another listed sub holding controlling five (listed) sub-sub holdings (Buitoni, Sabaudia, Olivetti, Sasib and Sogefi). AS such, the leadership represented by the De Benedetti family was able to raise a considerable amount of financial capital without losing control of the group, since the funds were managed primarily by employing instruments allowed by the Italian law granting the control over the voting capital, e.g. the issuing of non-voting preference shares without voting rights. This behaviour followed by nearly all the majors of the country. The resources were employed by the COFIDE's top management to finance the internationalization of the group and primarily in the (unsuccessful) takeover of the Société Génerale de Belgique in 1988.

18 Ibidem, Tab 5.1, p. 159, and Coltorti, "Note.." pp. 623-4

19 F. Barca, et al, *Assetti proprietari e mercato delle imprese*, Il Mulino, Bologna 1994, Vol. I, *Proprietà, modelli di controllo e riallocazione nelle imprese industriali italiane*, Ch. 1.

20 Franco Amatori and Francesco Brioschi, *Le grandi imprese private. Famiglie e coalizioni*, in Fabrizio Barca (ed.), *Storia del capitalismo itaiano dal dopoguerra ad oggi*, Donzelli, Roma 1997. Unfortunately, the literature available in English about this topici s scarce, especially in an historical perspective. See for instance Alberto Rinaldi, *Entrepreneurs and managers (1913-1972)*, in Renato Giannetti and Michelangelo Vasta (eds.), *Evolution of Italian Enterprises in the 20th Century*, Physica-Verlag, Heidelberg 2006, ch. 9.

21 This attitude is represented in a famous – even if never verified as effectively pronounced – sentence by Enrico Cuccia himself. Once told that the proportion of the shares owned by Mediobanca in the main industrial groups did not justify the Bank's real influence, he replied that "one has not to count the number of shares, but to take into account their *weight*", meaning with this sentence exactly that major, controlling shareowners' power was "obviously" to exceed the pure number of votes given the fact that they granted the

The presence of mutual funds was not, on the other hand, the starting point of a new governance model based upon the activism of institutional investors and/or financial institutions. In several cases the management of the funds followed an unwritten rule of abstention indirectly reinforcing the power of the main shareholders. Sometimes a fund belonged to the same group of the companies of which it was a shareholder. In these cases the funds' management supported the main shareholders[22]. The situation was aggravated by the fact that as far as pension funds are considered, the Italian retirement system has traditionally been a redistributive one. A State Agency (INPS, Istituto Nazionale della Previdenza Sociale) directly collected the money from the workers' wages to pay retirement fees. As such, the large amount of funds coming from the workers' wages was kept away from the capital market, and a relevant category of institutional investors, the funds – which elsewhere exerted a relevant monitoring and active role – banned from the Italian stock market.

A the beginning of the Nineties, notwithstanding the considerable development of Italian financial and stock markets, the situation was not too different from that described in the first part of this paper. In 1990 220 companies were listed to the Milan Stock Exchange compared to 649 in Germany, 443 in France and nearly 2000 in Great Britain. There were only 4 new listings, compared to 28 in Germany, 15 in France, 65 in Great Britain, the ratio between total stock value and GNP was 15.7 in Italy compared to 26.8 in Germany, 33.6 in France and 98.5 in Great Britain.

The market for corporate control was extremely reduced, if not totally absent, the control exerted by the main shareholders was contestable, and as mentioned above, that until 1992 when The Bill of 1936 was repealed, banks were not allowed to behave as German-style universal banks.

One major consequence of this situation was the enduring persistence of the institutional framework characterized by a very low degree of protection for minority shareholders due to the difficult enforcement of fiduciary duties of directors and inefficient takeover rules. Apart from the noticeable exception of Mediobanca, the banking system, in its turn, was still not able to exert a monitoring role as in Germany, and, even if to a different extent, in Japan. In brief, even with the presence of some typical characteristics of "European-style capitalism" in Italy, there were also notable differences from the Anglo-Saxon or German models. Specifically regarding the issue of agency problems and protection of minorities, the Italian system was different both from the German one, given the absence of general monitoring exerted by financial institutions and from the Anglo-Saxon one, considering the absence of an efficient market for corporate control and active – or potentially active – institutional investors. Majority shareholders, in general members also of the top-management – were not accustomed to confrontations with other stakeholders, shareholders agencies or watchdogs, an attitude which was to persist over time.

Not surprisingly, after some years of effervescence and after some managerial failures which resulted in huge losses for minorities[23], the trend in the stock market capitalization declined (even if not at the same level of the early Eighties), and the boom came to an end at the very beginning of the Nineties, due also to the negative global economic cycle.

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continuity in the (sometimes very difficult) management of the company.

[22] This happened for instance in 1989 when the mutual funds belonging to the Fininvest group of Silvio Berlusconi controlled 1% of the capital of Mondadori, a publisher that Berlusconi was trying to take over against Carlo De Benedetti, another tycoon controlling at that time the Olivetti group. There was a clear, potential conflict of interest between the interest of the main shareholder, the Berlusconi family, trying to use the funds to maintain control over Mondadori, and that of the funds' underwriters, interested in maximizing their immediate returns. This situation limited in a very serious way the control of the market over the resources allocation and the returns distribution.

[23] See for instance the case of the attempted takeover by the De Benedetti group to the Société Generale de Belgique at the end of the Eighties or the one by Pirelli to Continental at the beginning of the Nineties.

Table 1. Ownership structure of listed companies (%), early Nineties

	United States	Japan	Germany	Italy	UK
Financial Institutions	39.8	47.0	19.5	13.9	60.8
of which :					
Banks	0.3	25.2	8.9	10.9	0.9
Insurance Companies	5.2	17.3	10.6	0.8	18.4
Pension Funds	24.8	0.9	--	--	30.4
Others (Mutual Funds)	9.5	3.6	--	2.2	11.1
Non Financial Institutions	53.5	48.8	62.8	81.8	26.9
of which :					
Non Financial Companies	--	25.1	39.2	21.6	27.3
Government	--	0.6	6.8	28.0	2.0
Families/Individuals	53.5	23.1	16.8	32.2	21.3
Foreign property	6.7	4.2	17.7	4.3	12.3
Total	100.0	100.0	100.0	100.0	100.0

Source: Bianco and Casavola 1996: 431

3. The "cool revolution" of the Nineties

At the beginning of the Nineties the decline of the Italian State-owned enterprise system reached its lowest level. The close relationship between the political system and the State-owned enterprises by means of the Ministry of State Shareholdings, created in 1956, became the framework in which almost all the decision concerning the strategies of investment and growth took place – affecting seriously the competitiveness of the enterprises themselves[24].

In the same period the Italian State faced one of the most serious financial crises in its history. In 1992 the ratio between public debt (exceeding 800 billion Euros) and GNP reached 1.11 (1.23 in 1994) and the Italian Government was no longer able to assure the stability of the currency which was devaluated; in 1993 GNP decreased. The Prime Minister, at the time, the Socialist Giuliano Amato, drafted an "emergency plan" containing, among other programs, a program of privatisations which, to be effective, implied the creation of a complex and completely new legislative framework[25]. The huge losses of the many of the State-controlled firms were regularly compensated by the State, and hence a privatisation program was necessary to comply with the EU legislation concerning the competition policies inside the Union itself, and particularly the form of "State-aids".

Despite serious political obstacles the program was implemented. In 1994 with the introduction of "Law 474", a number of rules including some important corporate governance issues (for instance the limitation up to the 5% of the total capital for the single investor and the possibility for the Treasury to choose a *noyau dur*) were established. The privatisation process was successful in terms of returns: according to the data provided by the Treasury Ministry, from 1992 to 2001 the total earnings of the privatization process amounted up to about 112 billion Euros, among the highest in the world. The privatisation of Telecom Italia in 1997 was also the world's largest that year, reaching nearly 20 billion Euros.

The influence of the privatisation process on the Italian corporate governance system has been considerable. The way in which the privatisations in Italy were managed was, as mentioned above, different in terms of both dimension and the nature of the enterprise to be privatised from the methods followed in France and Britain. There were IPOs (in the case of IMI, a institute in charge of providing long and medium term credit, and INA, the National Insurance Institute), private contracts (e.g. in the case of Terni and Ilva Steelworks), public auction, or a mix between

[24] Amatori, *Between State and Politics.*
[25] *Legislative framework for the privatization process*

Law	Subject
Law 359/1992	Transforming the main State holdings into stock companies and conferring the shares to the Treasury
December 1992; Reorganization Plan for IRI, ENI, ENEL, IMI, BNL, INA	Definition of the strategic goals and selling policies
Decree 174/1993	Elimination of the Ministry for State Shareholdings
Law 474/1994	Fixing the rules for the sale of the State's shareholdings; introducing the principle of the golden share; subordinating the privatization of public utilities to the creation of Independent Authorities
Law 481/1995	Creating the Electric Energy Authority and the Telecommunications Agency

IPOs, offers for sale (OFS) and private contracts (especially in the case of the privatisation of former State monopolies – for instance, in the case of Telecom Italia).

Apart from the structure of the process, the strategy of creation of public companies *via* IPOs introduced for the first time and on large scale the problems of the accountability of management and corporate control, and potential discontinuities of the tradition of concentrated ownership. Moreover, this strategy implied a process of revision (and creation) of the rules governing the financial markets. This was an important step in the long-standing debate concerning the introduction of a modern system of industrial democracy in Italy which had been on going since the at least the fifties.

The improvement in the efficiency of the financial markets was pursued in two directions strictly linked each other. On the one side, it was necessary to increase market transparency by means of a set of rules ranging from the disclosure and regulation of shareholders' agreements to the protection of small shareholders, in this following the European regulation. On the other, the enlargement of the dimensions of the stock and financial markets became the primary goal. For the second time in a few years a favourable set of conditions emerged which could foster the convergence of the corporate ownership structures and governance practices towards higher standards.

Even though the Italian Stock Exchange - as explained above - maintained a low profile compared to other European countries, it is worth stressing the fact that its rate of growth was again, during the second half of the Nineties, among the highest in the world (Financial Times 1999). From 1992 up to 1999 market capitalization jumped from 11.5% of GNP to 62.1%; during 1998 the Milan Stock Exchange (MSE) grew more than 40%, twice the world's and Europe's averages.

The enlargement of the securities market was also due to two relevant forces, the slowdown of the public debt and the subsequent falling yield ratios of Treasury Bonds, together with a favourable fiscal policy that channelled a larger proportion of the private savings towards mutual funds[26].

Another relevant transformation involved the banking system. In 1990, the new Banking Act was passed by Parliament after a long debate. The law was a revision of the fore mentioned 1936 Bill: the first step was the transformation of the main banks, which were still under the control of the State, into joint stock companies. In 1992 following the EU legislation (Second EU Directive) the banks were allowed to invest in stocks, while in 1994 a consolidation act was passed allowing the banks to buy stocks but not exceeding (with only some exceptions) 15% of the bank's capital. The evolution of the banking system went systematically together with the privatisation of the main State-controlled banks, started in 1993. While the main banks begun to be present in stock ownership of industrial corporations, the most important industrial groups of the country did the same by buying shares of the banks. In addition to the revival in the stock market, these changes introduced - at least in theory - the possibility for the banking system to exert a positive monitoring role over the boards of the firms of which they were going to buy the shares.

The Corporate Law Reform

The previously held philosophy that favoured stability of control over the protection of small stakeholders (which resulted in the privatisation of the main state owned enterprises and created the small stable *noyaux durs*) was no longer consistent with the new political, economic and financial situation at the end of the Nineties. A number of different forces pushed, after several decades, towards a reform of Italian corporate law. Even though the stock exchange was steadily growing, both in terms of market capitalization and in number of listed companies, it was evident that the sustainability of the process depended on the possibility of involving foreign institutional investors. This in turn developed from the presence of strong and effective anti-director (in the Italian case, also controlling shareholders) rights, which at the end of the Nineties were remarkably low compared to the rest of the large European economies[27].

It s interesting to note how the reform of corporate law – one of the potentially most important reforms in the post-war economic period - was not designed by the Parliament but by an official of the Treasury Ministry, an MIT-trained economist Mario Draghi. At the beginning of the 1998 the so-called Legge Draghi (Draghi Law) became effective, the aim of the Bill was to improve the protection for minority shareholders in general enhancing disclosure. This improved protection would come by means of restrictive regulation of shareholder agreements - they had to be disclosed and in case of takeover bids, they were no longer going to be valid. Additionally restrictive regulation of takeover bids - a stake exceeding 30% of the capital compelled to extend the takeover bid on the whole capital. The law did not introduce a new structure of the Boards (that of Directors and that of the Auditors). Significantly, however, a representative of the minority shareholders had to be appointed to the board of the auditors, which should strengthen its role of supervision upon the management's activity.

[26] The percentage of mutual funds among the family's financial holdings rose from 2.5% in 1990 up to 10.2 in 1997, while in 1998 the properties of mutual funds reached nearly 10% of the whole stock market capitalization.

[27] See Franklin Allen, Laura Bartiloro and Oskar Kowalewski, *The Financial System of the EU 25*, June 2005, MPRA Paper No. 652, Online at http:// mpra.ub.uni-muenchen.de/ 652/, Figure 4.

Agencies and Authorities

The privatisation process had not only a considerable effect upon the structure of the financial markets and upon the corporate governance of the Italian enterprises. It also opened the political issue of the creation of independent agencies and authorities with the aim to control enterprises and markets, especially concerning public utilities. The creation of the Antitrust Authority (*Autorità garante della concorrenza e del mercato*) dates back to the 1990, followed during the Nineties by other agencies such as the Energy Authority created in response to the liberalization of the market. In the perspective of this paper, however, an important role is played by Consob (*Commissione Nazionale per le Società e per la Borsa - National Commission for Quoted Companies and the Stock Exchange*), the authority created in the mid-Seventies (1974) but *de facto* effective from the mid-Eighties, with a monitoring role over the listed companies (especially under the perspective of disclosure and transparency). With the reforms introduced by the *Legge Draghi* the Consob gained considerable power. The new consolidation act on finance gave Consob the responsibility of granting market transparency and the necessary information to avoid insider trading and mismatching, even though often its sometimes ambiguous behaviour is criticized.

At the end of 1999, a committee formed by experts issued the first version *Codice di Autodisciplina* (Self-issued Best Practice Code) for the listed companies[28]. In this case, the monitoring role over the companies' behaviour was given to the Stock Exchange itself[29].

5. The outcome at the beginning of the new millennium. Convergence lost between contingency and structure

It is not easy to evaluate the outcome of this tormented and articulated process. From the point of view of the history of corporate ownership and governance, that is, a long term perspective, the transformations occurred have been undoubtedly considerable, especially if one takes into account the obstacles provided by rent-protection behaviour and path dependence.

After decades during which the governance patterns and ownership structures were clearly defined and dominated by a very low degree of transparency and the separation of ownership and control, in a relatively short period the Italian policymakers successfully set up an ambitious privatisation process. They created and revitalized a number of Authorities and Agencies, issued new rules and new corporate law. They managed to dismantle the State monopolies, and keep the process moving in an unstable political framework. The reforms in the corporate governance of Italian large corporations were necessary in order to sustain the growth of the stock exchange and to make the Italian market attractive for the foreign institutional investors.

The majority of these goals have been undoubtedly successfully achieved. As is for other European countries, Italy now has a reasonable set of institutions regulating its financial market, useful tools to stimulate the growth of a number of public companies in the capital, technology and research intensive industries. According to the data available, the domestic stock market capitalization has more than doubled as percent of GDP, between 1995 and 2005, from 19 to 47%. During the same period, the total value of the equities traded as percent of GDP passed from 8% to 103%[30].

However, if one looks at some other indicators, the final outcome of this process appears to be far less effective than the efforts undertaken in order to achieve it. One simple indicator is quite telling: the total of assets under management by pension funds (as per cent of GNP) was 0.5 in 1995 and still less than 1% ten years later, while the same ratio, with reference to mutual funds is slightly less than 20%. The picture is even more puzzling if one looks at the structure of corporate ownership, both of listed and private large companies. The most important private corporations are still controlled and managed by individuals and/or families. At a glance, out of the top 20 national, non State-controlled and non foreign-controlled among the top 50 Italian corporations only one (Parmalat) can, after its bankruptcy in 2003, be considered a true public company with a widespread shareholders constituency. Obviously, considerations may vary according to the size and typology of the companies considered. As far as the listed companies included in the Top 30 Mediobanca Stock Index are considered, between 1995 and 2007, the transformations appear to be relevant, although not outstanding. According to these data, the total percentage of the controlling stakes on the total market capitalization of the 30 companies included in the index has declined, from 53.5% to 36.2%. The main "loser" in terms of ownership has obviously been the State, whose weight in controlling stakes declined from 70% to nearly 40% (which is nonetheless a considerable level). The banking system has not strengthened its position as a main shareholder, while families, other companies and foreign investors – in the sense of foreign direct investments – have increased their controlling stakes, in some cases considerably. Families, for instance, have increased from around 10% in 1995 to 15% in 2007, and foreign companies from 7.4% to 14.3%. As such, 30% of the controlling stakes "lost" by the State during the privatisation process have been more or less

[28] Unfortunately, not without interest conflicts. 17 out of the 22 members of the Commission were directly or indirectly involved in the companies which were to be regulated by the Code.

[29] For the last version of this code, see http://www.borsaitaliana.it/documenti/regolamenti/corporategovernance/corporategovernance.en.htm. Previous versions can be found in the same webpage.

[30] See footnote 16

equally divided among the market (+ 13.5%), and the other categories of controlling shareholders historically present in Italy: families/individuals, other companies (i.e., groups), and foreign investors. Apart from the State, families persist as the most important category of controlling shareholders, both in listed and non-listed companies. One issue that has not deeply investigated by the current literature is what extent the privatisation process in Italy has strengthened the privately owned, family-controlled groups. Groups controlled by families, such as the Barilla, Benetton, Caltagirone, Marcegaglia, Riva and a few others have enlarged their dimensions acquiring a considerable number of large, but also middle-size companies formerly controlled by the State. Nonetheless, the largest benefit had gone to multinational companies, which have been the most important buyers in terms of number of deals.

According to a more recent analysis, and to all the available sources, the privatisation process has progressively slowed down from the beginning of the new millennium[31], no clear strategy or programs have been presented by the last governments. A recent, and relatively symptomatic, event is the decision to privatize Alitalia, only after it the impossibility for the State to rescue the loss-making airline flag-carrier became clear due to the strong opposition of the EU.

What makes the Italian case interesting is when the issue of convergence is considered - the fact that the delay in the process was not only due to the persistence of strong institutional path dependence, or rent-seeking and opportunistic behaviour by the controlling groups. However, another - maybe even more relevant issue is the "structural" issue. The delay of the convergence process is derived from the intimate structure of the Italian capitalism. The crisis of the large corporations in the capital intensive industries at the beginning of the new millennium has left (together with the small firms active in the traditional, labour intensive industries) a cohort of middle-sized (with total sales ranging –roughly - from 10 million to 300 million Euros), internationalized players able to dominate worldwide in specialized niches (from machine tools, to chemicals, building materials and special steels). These companies – the majority of which is located in local production systems like the industrial districts - represent, at the moment, the most dynamic section of the Italian industrial capitalism, showing not negligible rates of growth of sales and exports[32]. During the last few years some of these companies actively took part in the privatisation process taking over significant sections of the formerly State-owned corporations.

Notwithstanding their dynamism, as far as ownership and organizational structures are considered these firms do not seem to provide an alternative model of governance from the traditional, based upon the identification between ownership and control and upon a strong "familist" culture. Significantly, few of these companies are listed and those that are, floated the minimum percentage of capital allowed. In general not more than the 30-40% of the whole share capital, which is still in the hands of the founders and of their families. The relative smallness of these companies and groups, together with their high levels of profitability enable controlling families to provide the necessary managerial resources, keeping their controlling power intact.

* * *

Italy has in sum, after a long and tormented process of institutional building, important regulatory institutions and modern corporate governance standards, coupled with the instruments (agencies and laws) to enforce them. However, there seems to be a sort of *mismatching* between the evolution of the institutions governing the Italian capitalism and the real economy. The regulatory institutions were updated exactly when the structure of the economic system was converging towards the small and medium dimension, which also in the future will presumably be dominated by the family ownership. It should be an interesting (but probably not too useful) exercise of counterfactual history to imagine what should have been the evolution of the Italian industry in presence of an effective regulatory system. This would in turn sustain an efficient Stock Exchange and an efficacious market for corporate control, providing the necessary financial resources to the capital and technology intensive industries of the third industrial revolution.

[31] Emilio Barucci, Federico Pierobon, *Le privatizzazioni in Italia*, Carocci, Roma 2007; www.privatizationbarometer.net

[32] See in this respect Mediobanca-Unioncamere, *Le medie imprese industriali italiane, 1996-2005)*, Milano 2006, available on-line (in Italian), at http://www.mbres.it/ita/mb_pubblicazioni/imprese.htm#. Profitability and other financial data of Italian medium-size enterprises (a san aggregate) in comparison with the large Italian corporations and the foreign-controlled ones are available at http://www.mbres.it/ita/download/rs_Quarto_Capitalismo_1997_2006.pdf