

CORPORATE GOVERNANCE IN ITALIAN LISTED COMPANIES AND COMPLIANCE TO BEST PRACTICES: AN EMPIRICAL RESEARCH

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Abstract

This study aims to: (1) monitor the evolution of corporate governance practices in Italian listed companies; (2) evaluate the formal and substantial compliance to the Corporate Governance Code; (3) define if listing segment/market (and consequently also capitalization) is significantly related with the adoption of best practices. The research arose from the analysis of data contained in an unpublished source of information made available by the public authority responsible for regulating the Italian securities market. We find that nearly every listed company adopts the Code and its most important best practices. However, we find some contradictory discrepancies. We also find that the adoption of the Code is significantly related to listing segment/market.

Keywords: Corporate governance, Best practices Code, Italy, Listed companies

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1. Introduction

The study is focused on and intends to monitor governance structures of Italian listed companies in three years (2003, 2004 and 2005), and to evaluate the compliance to the Italian Corporate Governance Code, assessing if the adoption of the Code supports the extent of best practice. It aims also to highlight the eventual critical aspects found. Similar analyses have been carried out in the last few years by other researchers throughout the world (e.g. Conyon and Mallin, 1997; KPMG, 2002; Dedman, 2002; Borsa Italiana, 2003; OECD, 2003; Werder *et al.*, 2005; Aguilera and Cuervo-Cazurra, 2009). In particular, our work is based on an unpublished source of information: the "Summary report" (*Scheda riepilogativa dell'attività di controllo*). The "Summary report" is a questionnaire that the Board of Auditors - a statutory and mandatory control board typical of the Italian corporate governance system - of listed companies should submit to Consob, the public authority responsible for regulating the Italian securities market. It is not a mandatory requirement, but it is recommended that the Boards of Auditors should do so. It is worth mentioning that Consob for the first time has allowed researchers to have access to the information contained in the "Summary report". Starting from that database we also tried to define if segment/market of listing is significantly related with the adoption of best practice.

We consider the information contained in this report to be a reliable and useful source because it is communicated directly by the Board Auditors of listed companies to the Italian regulator and it contains some information that is not usually available in other public sources of information.

2. Literature Review

2.1. Corporate governance and Code of Best Practice

In the last few years there has been a growth in the interest for corporate governance issues both in academic researches and from a normative point of view. The importance given to the protection of shareholders and stakeholders rights made corporate governance the focus of an intense debate in Italy (Barca, 1996; Bianchi *et al.*, 1997; Molteni, 1997; Melis, 2000), and throughout the world (see for example Shleifer and Vishny, 1997; La Porta *et al.*, 2000; Becht *et al.*, 2002; Khanna *et al.*, 2002; Denis *et al.*, 2003; Monks and Minow, 2004); also other events contributed to strengthen the interest for corporate governance issues, such as the market globalization, which has removed geographical barriers and generated the need for identifying standardized rules (Becht *et al.*, 2002; OECD, 2003; Reid, 2003). Market pressure on corporate governance issue has increased even more so after the

scandals and corporate failures that involved well-known companies in the last few years in many countries (Laing and Weir, 1999; Becht *et al.*, 2002; OECD, 2003). In addition, institutional investors, financial analysts and other “producers” of information have also a fundamental role to influence a growing pressure on the corporate governance topic (Rappaport, 1990; Pozen, 1994; Mallin, 1995; Useem, 1996; Becht *et al.*, 2002; OECD, 2003).

The Italian corporate governance system has its own unique features, and does not entirely fit into the “international standard models” (Moerland, 1995; Bianchi *et al.*, 1997; Melis, 2000; Amatori and Colli, 2001). From a macroeconomic perspective, it has

been argued that the prevailing corporate governance system in Italy is characterised by:

- a relatively poor capital market orientation (Pagano *et al.*, 1998);
- a limited role played by the market for corporate control (Melis, 2000), due to a rather concentrated control structure;
- the fact that, in contrast with the other main European corporate systems, neither institutional investors (as in the UK) nor banks (as in Germany) have a relevant influence on the corporate governance system (La Porta *et al.*, 2000).

Table 1. Ownership concentration in companies listed on the Italian Stock Exchange - MTA on 31.12.2004

	Ownership concentration (%)*		
	First shareholder	Other relevant shareholders	Market
1996	50.4	10.7	38.9
1997	38.7	8.4	52.9
1998	33.8	9.7	56.5
1999	44.2	8.2	47.6
2000	44.0	9.4	46.6
2001	42.2	9.2	48.6
2002	40.7	8.0	51.2
2003	33.5	11.6	54.9
2004	32.7	13.0	54.3

* % of market capitalization of ordinary capital of all listed companies on Italian Stock Exchange – Source: Consob, 2005

The “anomaly” of the Italian corporate governance model, characterized by pyramidal groups, family companies and state-controlled enterprises, has an influence principally in the mechanisms that assure transparency and protection to small investors (Bianchi *et al.*, 1997; Shleifer and Vishny, 1997; Giudici and Paleari, 1998; La Porta *et al.*, 2000). Therefore in Italy the main agency problem (Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983a, 1983b) seems to be the conflict of interests between the “shareholders-control group” and minority shareholders and between the “shareholders-control group” and bond-holders (Melis, 2000).

In corporate governance matters, disclosure is an essential issue because it increases the involvement of stakeholders (Laing and Weir, 1999), raises the attention of new potential investors and, in addition, stimulates the market of corporate control (Melis, 2000).

Companies operate in a competitive environment that is more and more selective and complex; therefore, they should be able to balance the need to keep reserved information considered “sensitive” from a strategic and competitive point of view (Campbell, 1976; Yosha, 1995; Pagano *et al.*, 1998), with the growing pressure to improve transparency and disclosure coming from the market, from public authorities and from the legal system (laws and enforcement).

In 1992, following a series of corporate scandals in UK, the Cadbury Committee issued the Code of Best Practice that identified a benchmark of good corporate governance (Cadbury Committee, 1992). This Code, as the Code issued in many other countries, was later reviewed and improved (Gregory and Simmelkjaer, 2002; Aguilera *et al.*, 2009; Zattoni and Cuomo, 2008). In such a context, at international level, companies developed the progressive adoption of best practices which, if adequately disclosed, allow a greater comparison of listed companies.

Following the process already started in many European countries, in Italy in 1999 was prepared and drew up a self-discipline Code, that identified a benchmark of good corporate governance, useful to guide the decisions of listed companies or of companies that aim at going public and gave to stakeholders a clear tool to recognize the compliance to the Code and to compare corporate governance models of different companies²⁰.

Corporate governance is defined by the Code as a set of rules according to which firms are managed and controlled, that “is the result of norms, traditions and patterns of behavior developed by each economic and legal system”. The Italian Code is a self-discipline Code and therefore is voluntary, but is based on the “comply or explain” principle, so

²⁰ The Code was partly reviewed in 2002 and in 2006 it was reviewed once again, in accordance with the new Italian legal system after 2004 reform.

companies that do not want to comply with it or only with a part of it, should inform the market in their annual corporate governance reports the reason for making such decision, on the basis of the principle “freedom with accountability”. The information is provided by way of a special report made available to shareholders.

The Code requires the compliance with best practices with reference to many aspects such as:

- role and composition of the Board of Directors, delegated powers and the manner of exercising them;
- appointment of independent directors;
- internal control system;
- procedure for the appointment of directors and their remuneration;
- handling of price sensitive information;
- relations with shareholders and investors;
- Board of Auditors.

For companies belonging to a specific segment (the STAR segment) and market (the Nuovo Mercato²¹) of listing, the Borsa Italiana regulations set out specific corporate governance requirements, in line with or even more stringent than the Code. So, each listed company should disclose information about its compliance to the Code, but only companies belonging to the STAR segment and the Nuovo Mercato have to comply with some provisions.

According with the Code, the Board of Directors performs a leadership function and has a fundamental role in examining and approving the company's strategic, operational and financial plans; it is also responsible for the internal control system, laying down the system guidelines and verifying that the main risks facing the company are identified and managed appropriately.

In Italy some researches have been conducted during the last few years to analyse the role and composition of the Board of Directors. In some of them, researchers highlighted the substantial inefficiency of the Boards of Directors (Corbetta and Tomaselli, 1996; Molteni, 1997), mostly because of the peculiar characteristics of the ownership structure of Italian listed companies (Barontini and Caprio, 2000).

The Code has contributed to spreading the relevance of the role of the Board of Directors. According to the recommendations of the Code, the Board of Directors should comprise executive and non-executive directors. Non-executive directors should, for their number and authority, have significant weight in the board's decision-making process; in order to ensure the protection of the minority shareholders, it is also recommended that an appropriate number of non-executive directors be “independent”, such as those who:

- do not entertain, directly, indirectly or on behalf of third parties, nor have recently entertained, with the company, its subsidiaries, its executive directors or the shareholders or group of shareholders who control the company, significant business relationships able to influence their autonomous judgment;
- do not own, directly or indirectly, or on behalf of third parties, a quantity of shares enabling them to control or notably influence the company or participate in shareholders' agreements to control the company.
- are not next of kin of the executive directors of the company or the people who are in the situations referred to in the above paragraphs.

The Board of Directors, on the basis of the information provided by each interested party, shall periodically assess the directors' independence. Independence of judgement is required to all directors, both executive and non-executive and that should be valued not only by looking at the “formal” respect of the Code; on the contrary it is important to assess the “substantial” compliance with the Code. In addition, it is relevant to say that independent directors should also have relevant professionalism and should give a positive contribution to Board activities (Andrews, 1981).

It's relevant to mention that STAR segment and Nuovo Mercato companies are bound to more stringent requirements regarding independent directors. The source of these requirements is the Borsa Italiana's rules, which are compulsory for the listing of such companies.

The Code affirms that “the internal control system is the set of processes for monitoring the efficiency of the company's operations, the reliability of financial information, the compliance with laws and regulations, and the safeguard of the company's assets”.

The definition adopted derived from the work of the CoSO Report and stresses the nature of a process involving all the company's functions. The responsibility for the internal control system is due to the Board of Directors. The Code recommends that this Board should be assisted by an Audit Committee and by “persons assigned to internal control function”. The latter should be free from hierarchical ties with the people subject to their control, in order to prevent interference with their independence of judgement. In addition, the Code affirms that in companies that have an internal audit function, the person appointed to run the internal control system can also be the head of that function.

The Audit Committee has been advocated as an important mechanism in the development of corporate governance internationally (Cadbury, 1992; KPMG, 2002; FEE, 2003), even though both researchers and regulators showed some concern about their effectiveness (Spira, 1999).

²¹ As happened also in other European countries, in Italy Nuovo Mercato has been closed following the New Economy crises.

The Code recommends that the Board of Directors establish an Audit Committee, charged with the task of giving advice and making proposals about problems considered important for the control of the company's activities. The Audit Committee should consist of non-executive directors, and the majority shall be independent. The Chairman of the Board of Auditors or another member of the Board of Auditors appointed by its President shall participate in the Committee's meetings.

The Code recommends also that the election of members of the Board of Directors should take place in accordance with a transparent procedure. Companies could for this reason establish a Nomination Committee to propose candidates for election, especially where the Board of Directors sees that it is difficult for shareholders to make proposals, as may be the case in listed companies with a broad shareholder base. According with the Code, companies that do not establish the Nomination Committee are not obliged to give information about the reasons of their choice.

Before 1999 in Italy the establishment of the Remuneration Committee was not common and there was a substantial lack of information about executive remuneration (Melis, 2000). The Code requires that the Board of Directors appoint a Remuneration Committee that shall submit proposals to the Board of Directors for the remuneration of the managing directors and of those directors who are appointed to particular positions and, acting on a proposal from the managing directors, for the criteria to be used in determining the remuneration of the company's top management. The majority of the Remuneration Committee members shall be non-executive directors.

2.2. The Board of Auditors' essential role in the Italian control governance system

The Board of Auditors was introduced in the Italian legislation in 1882 and since then represents a characteristic of the Italian corporate governance model. As a matter of fact, on the basis of the Italian traditional governance structure ("traditional model"), companies will be run by the Board of Directors and a mandatory second board, the "Board of Auditors" (*Collegio sindacale*), serve as an internal audit device (CNDC, 2003; Melis, 2004a). The presence of the Board of Auditors was required by the Italian civil law until the end of 2003, when a reform of corporate law, enforced since January 2004, introduced, as an alternative to the Board of Auditors, other institutions for the companies statutory control: the Board of Supervisors, derived from the German model, and the Audit Committee, derived from the Anglo-Saxon model. So, now Italian companies have the possibility to choose between the Board of Auditors and the other internationally most widespread internal control boards. However the present analysis is about the "traditional model", because till the end of 2005 the

Summary Report was submitted only by Italian companies with the "traditional model" of corporate governance.

In 1998 a law (commonly known as TUF), applicable to listed companies, put in the foreground the supervisory activity appointed by the Board of Auditors, to obtain an effective corporate governance. It introduced specific rules for listed companies and significant changes to the Board of Auditors' responsibilities (Melis, 2004a). An innovation was the extension of the tasks of the Board of Auditors to the supervision concerning the compliance with laws and bylaws, regarding the organizational structure and the accounting system; nevertheless the main innovation concerned the separation of the function of audit of the company's accounts, that from then on must be performed by an independent external auditing firm, from the other responsibilities of the Board.

Board of Auditors is in the middle of a significant stream of information which allows the members to perform their function. They receive information from the Board of Directors, the Executive Committee, the Audit Committee, the person assigned to internal control functions, the external Auditing Firm, the shareholders and Consob. In particular, Board of Auditors must communicate to the Italian regulator any misconduct and irregularities noticed during its control activities and to pass on any useful information.

Experienced people having background in accounting, auditing, economics and law or in other technical disciplines related to the company's business should be selected for the appointment to the Board of Auditors of listed companies. Thus, requirements for appointment as a Board of Auditors member consist in educational and independence requirements (university and professional qualification, incompatible activities), to assure professional competence and independence.

The Board of Auditors should know very well the company characteristics as well as the competitive market where the company acts, in order to understand economic and financial results of the company.

The Board is structured as a collegial entity and, therefore, the various functions must be accomplished by the Board as a whole and not by the single members. Board of Auditors, according with the TUF, should consist of at least three permanent members and two additional (auxiliary) members, to be held as reserve in the event that one of the permanent members cannot fulfil his duties.

The TUF was partly changed in December 2005; till then it stated that "*the bylaws shall contain the clauses necessary to ensure that one of the Auditors is elected by the minority shareholders. Where the Board consists of more than three Auditors, the*

number of Auditors elected by the minority shareholders may not be less than two”²².

To be a member of Board of Auditors of listed companies is a demanding and time consuming activity: the Board of Auditors has to meet at least once every three months and the members of the Board of Auditors are required to participate in meetings of the Board of Directors, Executive Committee, and Shareholders’ Meetings; therefore the Board of Auditors members shall accept their appointment to the Board when they deem they can devote the necessary time to the diligent performance of their duties, taking into account, among other things, the number of positions they hold on the Boards of Directors or on the Board of Auditors of other companies.

3. Methodology and Data

The Board of Auditors is required to submit annually a report to the shareholders’ meeting. Along with the report to the shareholders’ meeting the Board of Auditors gives an account of its oversight activities and also expresses its opinion on the work of the directors.

In consideration of the significant importance of the report to the shareholders’ meeting, Consob recommended to Boards of Auditors, as a guideline, the submission of a “Summary report” (*Scheda riepilogativa dell’attività di controllo*), a YES or NO questionnaire that contains information about the composition of the Board of Auditors (number of statutory members, members appointed by minority shareholders, number of similar appointments that a member of the Board of Auditors concurrently holds with other companies), its oversight activities, its opinion about corporate disclosure and corporate governance, the analysis of the observance of the Corporate Governance Code, and, finally, the analysis of the contents of the Board of Auditors’ report at the shareholders’ meeting.

Differently from the information contained in the corporate governance report which, since March 2000, Borsa Italiana has asked listed companies to issue annually, this information source is addressed only to a single stakeholder, the Supervisory Authority, it is compiled by the Board of Auditors

instead of the Board of Directors and it contains information usually not available in other public source of data. We analysed the answers to all the questions in the Summary report, with the exception of data identifying the companies and the Board of Auditors’ members. In particular, we focus our attention on questions concerning corporate governance matters.

The analysis refers to 747 “Summary reports” of which 261 were sent to Consob sent by as many Italian listed companies during 2003, 246 during 2004 and 240 during 2005.

The study intends to evaluate the compliance to the Corporate Governance Code and aims at underlining the contingent critical aspects found. Recent researches show that, as in other countries (Dedman, 2002; Werder *et al.*, 2005), also in Italy there is a high level of adoption of the Code and that there has been a progressive increase during the last years (KPMG, 2001; Borsa Italiana, 2003). According with these considerations, the first issue we want to study is the level of adoption of the Corporate Governance Code in 2003, 2004 and 2005, also with reference to the main best practices it refers to. We analysed also other two relevant best practices even if they are not included in the Code, regarding the choice to give consulting tasks, non-audit, to the Auditing firm and to Auditing firm staff and the composition of the Board of Auditors (the number of members of the Board of Auditors; the presence of members of the Board of Auditors appointed by the minority shareholders; the number of position concurrently held by Board of Auditors members in other listed and not listed companies and in other group companies).

So, the data collected was used to study in depth the following issues (*best practices*):

1. Compliance with the *Code* (COMP_CODE), a binary response variable taking the values 0 and 1 with 0 indicating “no” and 1 “yes”;
2. Presence of at least one independent directors in the Board of Directors (IND_DIR), a binary response variable taking the values 0 and 1 with 0 indicating “no” and 1 “yes”; in the “Summary Reports”, the Boards of Auditors are not asked to express any valuation about the “substantial” independence of the independent directors but only to state if there are independent directors in the Board and if their number is adequate.
3. Presence of persons assigned to internal control functions (P_IC), a binary response variable taking the values 0 and 1 with 0 indicating “no” and 1 “yes”;
4. Audit Committee (IC_COMM), a binary response variable taking the values 0 and 1 with 0 indicating “no” and 1 “yes”, and number of Audit Committee’s meetings held during the year (N_IC_COMM);

²² The new version of TUF states: “The bylaws of a company shall establish, for the board of auditors:

- a) the number, not less than three, of auditors;
- b) the number not less than two, of alternates.

Consob establishes the rules for the election procedure by list vote of a member of the Board of Auditors by minority shareholders, who are not linked, not even indirectly, to the shareholders who presented or voted the list which resulted first by number of votes.

The chairman of the board of auditors shall be appointed by the shareholders’ meeting from among the auditors elected by the minority shareholders”.

5. Nomination Committee (NOM_COMM) and Remuneration Committee (REM_COMM), binary response variables taking the values 0 and 1 with 0 indicating “no” and 1 “yes”, and number of Committees’ meetings held during the year (N_NOM_COMM and N_REM_COMM);
6. Consulting tasks, non-audit, to the Auditing firm (CT_AF) and to Auditing firm staff (CT_AFS), binary response variables taking the values 0 and 1 with 0 indicating “no” and 1 “yes”;
7. Number of the Board of Auditors’ member (N_BOA), election of at least one member by minority shareholders (MS_BOA), a binary response variable taking the values 0 and 1 with 0 indicating “no” and 1 “yes”, and number of positions concurrently held in other companies.

To evaluate critical aspects, we have also analysed if companies that affirm to comply with the Code respect all of its recommendations, and in particular the appointment of independent directors, the appointment of persons assigned to internal control functions and the institution of Committees. To determinate which, if any, of the explanatory variables considered (IND_DIR, P_IC, IC_COMM, NOM_COMM, REM_COMM) are predictive of “COMP-CODE”, (adhesion or not to the Corporate Governance Code) we use a multiple logistic regression model.

Finally, to evaluate if listing segment/market influence the adoption of best practice, according to information available, listed companies that sent the “Summary Report” are classified on the basis of:

- the different equity markets of Italian Stock Exchange (Mercato Telematico Azionario - MTA, Nuovo Mercato and Expandi – before 2003 called Mercato Ristretto) and listing segments (with reference to MTA: Blue chips, STAR, Segmento Ordinario classe 1 and Segmento Ordinario classe 2) in which they were listed at the end of the previous year of analysis, according to the Borsa Italiana’s annual report. Many details about characteristics and requirement of market and listing segment are shown in the square below²³; different segments or markets of listing are related with capitalization.

As already said, for companies belonging to specific equity markets or listing segments of the Italian Stock Exchange, the Borsa Italiana regulations set out specific requirements for corporate governance, in line with or even more stringent than the Code. Moreover, companies with a higher capitalization, even if the Borsa Italiana regulations

don’t set out specific governance requirements, are encouraged by the financial market (analysts, fund managers etc.) to adopt best practices. Researches show that bigger companies have also bigger Board of Directors and more independent directors (Stapledon and Lawrence, 1996; Lawrence and Stapledon, 1999); dimension seems also to influence the appointment of Board Committees (Pincus et al, 1989; Carson, 2002).

A hypothesis to test is: *the adoption of the Corporate Governance Code and of best practices is related to listing segment/market.*

²³ Borsa Italiana markets and listing segments changed periodically; however for our analysis we have considered the situation existing at August 2005.

Blue chips – MTA: the equity share market segment that includes big companies with a capitalization above 800 million euros;

Segmento Ordinario classe 1 – MTA: the ordinary segment dedicated to companies with a market-capitalization lower than 800 million of euros not belonging to the STAR segment but with fairly good companies' liquidity and average daily turnover of trades;

Segmento Ordinario classe 2 – MTA: the ordinary segment dedicated to companies with a market-capitalization lower than 800 million of euros but with low companies' liquidity and average daily turnover of trades;

STAR – MTA: the high standard mid cap equity share market dedicated to companies with a market-capitalization lower than 800 million euros, complying with specific requirements in terms of liquidity, transparency and corporate governance; in particular STAR companies should appoint at least 2 independent directors and create an Internal control and a Remuneration Committee;

Nuovo Mercato: the market dedicated to companies with high growth potential, characterized by an innovative approach to product, process or services; with reference to corporate governance rules, Nuovo Mercato companies should appoint a number of independent directors related to Board of Directors size and create an Audit Committee;

Expandi: especially designed for small companies, with a consolidated position in their markets and a track record of positive economic and financial results.

The following *Table* indicates the cases analysed. It's worth mention that in 2003 about 10% of the Boards of Auditors did not send the “Summary report”. In 2004 e 2005 the situation results substantially unchanged.

Table 2. Data

Equity Market/Listing Segment		Year			Total
		2003	2004	2005	
Blue chips - BIG	Count	71	70	72	213
	%	27.2%	28.5%	30.0%	28.5%
STAR – MEDIUM	Count	38	36	40	114
	%	14.6%	14.6%	16.7%	15.3%
Ordinario – MEDIUM	Count	106	100	89	295
	%	40.6%	40.7%	37.1%	39.5%
Nuovo Mercato - MEDIUM	Count	36	31	28	95
	%	13.8%	12.6%	11.7%	12.7%
Expandi - SMALL	Count	10	9	11	30
	%	3.8%	3.7%	4.6%	4.0%
Total	Count	261	246	240	747
	%	100.0%	100.0%	100.0%	100.0%

The following sections show the results of analysis regarding compliance with the Code and the adoption of best practices.

4. Results

4.1. The compliance to the Corporate Governance Code and the spreading of best practices

Our analysis confirms that in Italy there is a good level of adoption of the Code. The percentage of companies that complied with the Code is very high in 2005 - around 92% of listed companies analysed -, but was substantially unchanged during the three

years. Only 8% of the analysed companies did not formally adopt the Code.

Our analysis confirm also that the percentage of companies that complied with many recommendations of the Code was very high in 2005: around 96% of Italian listed companies had at least one independent director in their Boards of Directors, 90% had appointed persons assigned to internal control functions, 83% had the Audit Committee and 73% had the Remuneration Committee.

The analysis show that the percentage of companies that complied with the Code recommendations analysed was growing, but there was no evidence of a significative difference through the years.

Table 3. Compliance with the Code and with some best practices

	2003	2004	2005
Compliance with Corporate Governance Code	92.3%	92.7%	92.1%
Presence of Independent directors in the Board of Directors of listed companies	93.9%	95.5%	96.3%
Presence of persons assigned to internal control functions	83.5%	86.2%	89.6%
Establishment of the Audit committee	75.9%	80.1%	82.9%
Average number of meetings held by the Audit committee	4.7	4.2	4.8
Establishment of the Nomination committee	11.1%	11.4%	12.9%
Average number of meetings held by the Nomination committee	1.7	2.2	2.3
Establishment of the Remuneration committee	66.3%	67.9%	72.9%
Average number of meetings held by the Remuneration committee	1.9	1.9	2.0
Consulting non-audit tasks to the Auditing firm	51.3%	56.1%	61.3%
Consulting non-audit tasks to Auditing firm staff	28.7%	28.9%	27.1%
Board of Auditors made by more than 3 members	10.0%	11.0%	10.0%
Presence in Board of Auditors of at least a member appointed by minority shareholders	26.4%	33.3%	33.3%

4.2. Compliance with the Corporate Governance Code

We related companies that affirmed to comply with the Code and the respect of some of its recommendations such as the appointment of independent directors, the establishment of Committees and the appointment of persons assigned to internal control functions. What we tried to do is to understand if the company statements about compliance with best practices might be misunderstood by stakeholder. This could happen if listed companies do not specify that the compliance is only partial.

Focusing on 2005 data, we find a significative relation between affirming to comply with the Code and the compliance with some of its main recommendations, and in particular with:

- the presence of independent directors in the Board of Directors (variable "IND_DIR"): *Cramer's V 0.348; p-value 0.001*;
- the presence of persons assigned to internal control function (variable "P_IC"): *Cramer's V 0.153; p-value 0.018*;
- the presence of the Audit Committee (variable "IC_COMM"): *Cramer's V 0.441; p-value 0.001*;
- the presence of the remuneration Committee (variable "REM_COMM"): *Cramer's V 0.342; p-value 0.001*.

As expected, companies that affirmed to comply with the Code usually complied also with its main recommendations.

There are 3 companies that complied with no best practice among the ones analysed. These companies affirmed obviously to not comply with the Code. Anyway, in 2005 there were 19 companies that affirmed to not comply with Code but that were compliant with at least one best practice:

- 4 companies complied with only one best practice (2 companies had only at least one independent director and 2 only persons assigned to internal control functions);
- 6 companies complied with two best practices (having both independent directors and persons assigned to internal control functions);
- 2 companies complied with three best practices (1 company had appointed at least one independent director, persons assigned to internal control functions and the Audit Committee or the Nomination Committee);
- 4 companies complied with four best practices (having at least one independent director, persons assigned to internal control functions, the Remuneration Committee and the Audit Committee).

In particular, considering the best practices we analysed, we find that more than 56% of listed companies in 2005 complied with 4 best practices and 12% with all of it. More than 98% of listed companies analysed in 2005 complied with at least one best practice.

Table 4. Number of best practices to which Italian listed companies comply with in 2005

N. best practices	Frequency	Percent	Cumulative Percent
0	3	1.3	1.3
1	16	6.7	7.9
2	22	9.2	17.1
3	34	14.2	31.3
4	136	56.7	87.9
5	29	12.1	100.0
Total	240	100.0	

In particular we note that approximately 83% of listed companies analysed had the Audit Committee. So, we tried to determinate which, if any, of the explanatory variables considered are predictive of "COMP_CODE". As already said, among the 240 companies observed in the year 2005, 221 (92.1%) affirmed to comply with the Corporate Governance Code. The five explanatory variables are: presence of independent directors, presence of persons assigned to internal control functions, presence of the Audit

Committee, Nomination Committee and Remuneration Committee).

The characteristic of the outcome variable leads to analyse data with a multiple logistic regression model. The model has been constructed considering simultaneously all the five explanatory variables so the effects of each variable is adjusted for the remainder. The results are showed in the following table:

Table 5. Compliance with Corporate Governance Code: a multiple regression model

Variables in the Equation	Beta	S.E:	P value	OR	95% confidence limits for OR	
					Lower	Upper
IND_DIR (YES vs. NO)	1.14	0.80	0.15	3.11	0.66	14.78
P_IC (YES vs. NO)	-0.36	0.68	0.59	0.70	0.18	2.63
IC_COMM (YES vs. NO)	2.02	0.76	0.01*	7.50	1.70	33.09
NOM_COMM (YES vs. NO)	-0.03	1.16	0.98	0.97	0.10	9.42
REM_COMM (YES vs. NO)	1.30	0.78	0.09†	3.68	0.80	16.88
Constant	-0.13	0.81	0.88	0.88		

Model summary (Pseudo R square): Cox&Snell (0.149); Nagelkerke 0.351.

Model Chi square = 38.809; $p < 0.001$

The only significant effect on "COMP_CODE" is due to "IC_COMM". The estimated odds ratio adjusted for the effects of the other variables is 7,501 (95% CI: 1,700-33,091). Thus, using the fitted model, we find that for a business with "IC_COMM" the probability of "COMP_CODE" is more than seven times higher than a business without "IC_CODE". Among the other predictor variables, worth note only "REM_COMM".

4.3. Presence of independent directors in the Board of Directors of listed companies

More than 96% of listed companies analysed had in their Boards of Directors at least one independent

director and in particular there were independent directors in all Blue chips, STAR and Nuovo Mercato companies.

In 2003 16 companies analysed did not appoint any independent directors, while in 2004 only 11 companies did not do that. In 2005 only 9 companies did not appoint any independent directors (7 Ordinario and 2 Expandi).

In 2005 4 companies stated the adoption of Corporate Governance Code but in spite of that, they did not appoint any independent directors. On the other hand, 14 companies, even though did not adopt the Code, however appointed at least one independent director.

Table 6. Adoption of the Code and presence of Independent Directors – 2005

2005	Adoption of the Code			
		YES	NO	Total
Presence of Independent directors	YES	217	14	231
	NO	4	5	9
	Total	221	19	240

The Code recommends that an adequate number of independent directors should be elected to the Boards of Directors of listed companies in relation to the total number of non executive directors and significant in terms of representativeness.

In 2005, in 6.5% of companies (15 cases) the Boards of Auditors thought the number of independent directors was inadequate (the answer is NO or Not Applicable – NA; the latter is used when there are no independent directors in the Board).

Table 7. The Board of Auditors' opinion about the adequacy of the independent directors' number

	2003	2004	2005
YES	90.4%	93.5%	93.7%
NO	3.5%	2.4%	2.1%
Not Applicable	6.1%	4.1%	4.2%

It is positive to notice that the percentage of the Board of Auditors that thought the number of independent directors is inadequate decreased during 2004 and 2005. In conclusion, we can affirm that the appointment of independent directors in the Italian listed companies has become a widespread "practice", even if some exceptions continue to exist.

In 2005, persons assigned to internal control functions were appointed in approximately 90% of the companies analysed. We can notice an improvement compared with data of 2003 and 2004. The percentage of companies that, on one hand, declared to adopt the Code but, on the other hand, did not assign persons to internal control functions, decreased (from 13.8% in 2003 to 8.3% in 2005) and we also notice that there were 14 companies that, even if they did not adopt the Code, however had persons assigned to internal control functions.

4.4. Presence of persons assigned to internal control functions

Table 8. Adoption of the Code and presence of persons assigned to internal control functions – 2005

2005	<i>Adoption of the Code</i>			
		YES	NO	Total
<i>Presence of persons assigned to internal control functions</i>	YES	201	14	215
	NO	20	5	25
	Total	221	19	240

4.5. Establishment of the Audit Committee

In 2005 the percentage of companies that established an Audit Committee increased (82.9% in 2005 compared with 75.9% in 2003 and 80.1% in 2004) while there was a 7% decrease of companies that, on one hand, declared to adopt the Code and, on the other hand, did not establish the Audit Committee

(from 18% to 11%). In 2005 there are 27 listed companies that affirmed to comply with the Code but that had not an Audit Committee. In very few cases (5 companies), listed companies established the Audit Committee even though they declared that the Code is not adopted.

Table 9. Adoption of Code and establishment of the Audit committee – 2005

2005	Adoption of Code			
		YES	NO	Total
Establishment of the Audit committee	YES	194	5	199
	NO	27	14	41
	Total	221	19	240

We notice that in 2005 the average number of meetings that the Audit Committee held yearly is very low: only 4 meetings, although we observe an

improvement compared with the data of 2003 and 2004 (from 3.72 meetings held in 2003 to 4.21 in 2004 and 4.75 in 2005).

Table 10. Average number of meetings that the Audit committee held yearly

Year	Mean	N. of companies with an Audit committee	Std. Deviation
2003	3.72	198	3.00
2004	4.21	197	3.02
2005	4.75	199	3.29

Also at international level is observed a low average number of meetings held by the Audit Committee (Allegrini *et al.*, 2004), so that the Italian context seems similar to the one found in other countries. We should also remember that in Italian companies the Board of Auditors integrates the Audit Committee role.

We can gather that sometimes the Audit Committee has been established but it was substantially “inactive” because it did not even hold one meeting during the year. In this case, the company should be very careful in communicating that it established the Committee because it had not acted and the company should be accountable of that choice.

Table 11. Establishment of the Audit committee

	Establishment of the committee	Establishment of the committee but no meetings	Committee Absence	Total
2003	70.5%	5.4%	24.1%	100.0%
2004	76.8%	3.3%	19.9%	100.0%
2005	80.0%	2.9%	17.1%	100.0%

So, while 82.9% of the analysed companies in 2005 (80% + 2.9%) declared to have the Audit Committee, only 80% of those companies have an “active” Committee. In reference to this issue we observed an improvement from 2003 to 2005, even though for a small number of companies we found a significant contradiction.

Finally, looking only to companies with an “active” Audit Committee, we note that during 2005 in only the 7.8% of them the Committee held more

than 10 meetings. So the great majority meets less than once a month.

4.6. Establishment of the Nomination and Remuneration Committee

Data show that the Nomination Committee has been established in 2005 in 31 companies, out of 240 companies analysed.

Table 12. Adoption of the Code and establishment of the Nomination committee – 2005

2005	Adoption of the Code			
		YES	NO	Total
Establishment of the Nomination committee	YES	30	1	31
	NO	191	18	209
	Total	221	19	240

In the three years the percentage of companies that declared to adopt the Code but that at the same time had not a Nomination Committee was slightly decreased (from 81.3% in 2003 to 82.3% in 2004 to 80% in 2005).

The average number of meetings that the Nomination Committee held yearly is very low (on

average it held meetings twice a year) and was substantially unchanged during the analysed period.

73% of the companies analysed in 2005 established a Remuneration Committee (compared with 66% in 2003 and 68% in 2004).

Table 13. Adoption of the Code and establishment of the Remuneration committee – 2005

2005	Adoption of the Code			
		YES	NO	Total
Establishment of the Remuneration committee	YES	171	4	175
	NO	50	15	65
	Total	221	19	240

50 listed companies (20%) affirmed to adopt the Code even if they did not establish the Remuneration Committee (compared with 27% in 2003 and 26% in 2004) and in 2005 there were also a small number of companies (exactly 4 companies) that established the

Remuneration Committee even if they did not adopt the Code.

There were a 12% of companies in 2005 that established the Remuneration Committee even if it had no meeting during the year. This percentage decreased during the analysed years.

Table 14. Establishment of the Remuneration Committee

	Establishment of the Committee	Establishment of the Committee but no meetings	Committee Absence	Total
2003	50.2%	16.1%	33.7%	100.0%
2004	56.9%	11.0%	32.1%	100.0%
2005	60.8%	12.1%	27.1%	100.0%

The average number of meetings held by the Remuneration Committee during the year was low: 2 meetings held on average (compared with 1.93 in 2004 and 1.88 in 2003). We can affirm, as already said with reference to the Audit Committee, that in the three years analysed the number of companies that established the Remuneration Committee was increased but there were still some companies where the Committee had been “formally” established but at the same time it had been “substantially inactive” because it didn’t hold even one meeting during the year.

4.7. Consulting, non-audit, tasks to the Auditing firm and to the Auditing firm staff

Our analysis show that the percentage of companies that gave other consulting tasks, non-audit, to the Auditing firm or to the Auditing firm staff was not significantly changed during the observed period.

Companies that gave other tasks non-audit to the Auditing firm were a significant number (61% in 2005, 56% in 2004 and 51% in 2003). Also the percentage of listed companies that gave other tasks non-audit to the Auditing firm staff (27% in 2005, 28.9% in 2004 and 28.7% in 2003) was still significant.

4.8. Board of Auditors composition

The presence in Boards of Auditors of at least a member appointed by minority shareholders was not significantly changed during the observed period. 90% of the listed companies analysed in 2005 had only three permanent members (the minimum number required by the law). In 10% of the companies the Board of Auditors consisted in five permanent members, while no company had a Board of Auditors with more than five permanent members.

Table 15. Composition of the Boards of Auditors – number of members

Number of Board of Auditors members	2003	2004	2005
3	90.0%	89.0%	90.00%
More than 3	10.0%	11.0%	10.00%

We note that only 33% of Boards of Auditors analysed had at least one member appointed by minority shareholders, compared with 27% in 2003. So the percentage increased during the analysed years,

even though only two thirds of the companies had not Board of Auditors members appointed by minority shareholders.

Table 16. Board of Auditors with at least a member appointed by minority shareholders

	2003	2004	2005
No	192	164	160
%	73.6%	66.7%	66.7%
Yes	69	82	80
%	26.4%	33.3%	33.3%
Total	261	246	240

As already assumed, the TUF stated also that where the Board of Auditors consists of more than three Auditors, the number of Auditors elected by

minority shareholders may not be less than two. So, based on our data, companies that strictly respected

the TUF were only 32.5% in 2005 (compared with 31% in 2004 and 26% in 2003).

Only 1 company in 2005 (also 1 in 2004 and 2 in 2003) affirmed to have a Board of Auditors with all the members appointed by minority shareholders.

We note also that about 90% of the Boards of Auditors members had more than three “positions” in listed and non-listed companies. There were also many Board of Auditors members that had simultaneously more than 20 “positions” in other listed and non-listed companies; some Auditors had more than 50 “positions”.

To be a member of a Board of Auditors of a listed company is a time-consuming and demanding

activity so each member should assure that he/she can devote the necessary time to the diligent performance of their duties. Therefore it is unexpected to find that so many Board of Auditors members concurrently held such a high number of “positions” in listed and non listed companies.

On average, the number of “positions” held in other group companies was also high. About 60% of the Boards of Auditors members had at least one “position” in other group companies and more than 82% of the members had no more than three other “positions” in other group companies.

Table 17. Number of “positions” in listed and non-listed companies *

N.	2003	2004	2005
From 1 to 3	12.9%	9.5%	11.1%
From 4 to 10	24.3%	25.5%	25.7%
From 11 to 20	25.1%	29.5%	26.2%
From 21 to 30	16.1%	17.0%	16.7%
From 31 to 50	17.1%	14.1%	15.9%
More than 50	4.4%	4.4%	4.6%

Table 18. Number of “positions” in other group companies

N.	2003	2004	2005
0	38.6%	40.1%	41.3%
From 1 to 3	43.7%	44.0%	41.1%
From 4 to 10	15.2%	14.4%	15.9%
From 11 to 20	1.7%	1.5%	1.7%
More than 20	0.8%	0.0%	0.0%

* In the “Summary Reports” data we found some evident mistakes with reference to the number of “positions” held by Board of Auditors members; for example, some of them affirmed to have no “position” in listed companies even if they held a “position” in the Board of Auditors of the company for which they sent the “Summary Report”.

Finding the same people as members of Boards of Auditors of more than one company of the same group increases, in our opinion, the possibility of creating strong relations among the control systems of both the companies and the stream of information could be more robust and direct. Nonetheless, we also think that, if the Boards of Auditors of two companies of the same group are composed exactly by the same people, stakeholders could be less protected and accountability of the whole group could worsen.

Conclusively, we can affirm that the degree of adoption of the Corporate Governance Code in Italy is high and constant during the 2003, 2004 and 2005; a lot of listed companies comply with Code recommendations even if we found that some best practices not included in Code are usually not observed: a lot of companies gave consulting, non-audit, tasks to the Auditing firm and very few companies had Board of Auditors with more than five members and with at least one of them appointed by minority shareholders.

4.9. The market/segment of listing: relation with compliance to corporate governance code and best practices

Our analysis shows that compliance with the Corporate Governance Code and with best practices is significantly related with the market or segment of listing. In particular we find that the presence of at least one independent directors (p-value 0.01), the presence of persons assigned to internal control functions (p-value 0.01), the establishment of the Audit Committee (p-value 0.01) and of the Remuneration Committee (p-value 0.01), the presence of Board of Auditors made by more than 3 members (p-value 0.01) are related with the market and segment of listing.

As expected, in particular Blue chips and STAR companies complied more frequently with the Code and its best practices. As a matter of fact, Blue chips and STAR companies gave more often also other consulting, non-audit, tasks to the Auditing firm and to the Auditing firm staff.

Table 19. Compliance with the Corporate Governance Code and with best practices: relations

	Pearson Chi-Square	Cramer's V	p-value
Compliance with the Corporate Governance Code	30.02	0.35	0.01
Presence of independent directors in the Board of Directors of listed companies	15.98	0.26	0.01
Presence of persons assigned to internal control functions	14.48	0.25	0.01
Establishment of the Audit Committee	62.82	0.51	0.01
Establishment of the Remuneration Committee	60.87	0.50	0.01
Consulting non-audit tasks to the Auditing firm	22.66	0.31	0.01
Consulting non-audit tasks to Auditing firm staff	12.39	0.23	0.02
Board of Auditors made by more than 3 members	15.89	0.26	0.01

All Blue chips and STAR companies affirmed to comply with the Code, while only the 96% of Nuovo

Mercato, the 84% of Ordinario and the 63% of Expandi companies.

Table 20. Compliance with Corporate governance Code

	2003	2004	2005
Blue chips	100.0%	100.0%	100.0%
STAR	100.0%	100.0%	100.0%
Ordinario	86.8%	86.0%	84.3%
Nuovo mercato	97.2%	96.8%	96.4%
Expandi	50.0%	66.7%	63.6%
Total	92.3%	92.7%	92.1%

All Blue chips, STAR and Nuovo Mercato companies affirmed to have at least one independent

director in their Board of Directors, while only the 92% of Ordinario and the 82% of Expandi companies.

Table 21. Presence of independent directors in the Board of Directors of listed companies

	2003	2004	2005
Blue chips	98.6%	100.0%	100.0%
STAR	100.0%	97.2%	100.0%
Ordinario	88.7%	91.0%	92.1%
Nuovo mercato	97.2%	100.0%	100.0%
Expandi	80.0%	88.9%	81.8%
Total	93.9%	95.5%	96.3%

In 2005 approximately all Blue chips companies had persons assigned to internal control functions, while only 63% of Expandi companies had the same

role, but the percentage is doubled respect to the previous year.

Table 22. Presence of persons assigned to internal control functions

	2003	2004	2005
Blue chips	95.8%	97.1%	97.2%
STAR	92.1%	86.1%	92.5%
Ordinario	80.2%	85.0%	85.4%
Nuovo mercato	75.0%	80.6%	89.3%
Expandi	30.0%	33.3%	63.6%
Total	83.5%	86.2%	89.6%

As expected, all the STAR and Nuovo Mercato companies had an Audit Committee (in 2004, 2 companies did not have an Audit Committee). The

establishment of the Audit Committee was less frequent in companies of Ordinario segment and Expandi.

Table 23. Establishment of the Audit Committee

	2003	2004	2005
Blue chips	88.7%	91.4%	93.1%
STAR	92.1%	94.4%	100.0%
Ordinario	62.3%	69.0%	69.7%
Nuovo mercato	91.7%	87.1%	100.0%
Expandi	10.0%	33.3%	18.2%
Total	75.9%	80.1%	82.9%

From 2003 to 2005 we observe an increase of the average number of meetings held by the Audit Committee in every listing segment. In particular in STAR and Blue chips companies the Audit Committee held an average number of meetings

higher than the other listed companies. We found the higher frequency of meetings of Nomination and Remuneration Committees in companies with a higher capitalisation (Blue chips companies).

Table 24. Average number of meetings held by the Audit, Nomination and Remuneration Committee (in companies that established the Committee) – 2005

	N. of companies with an Audit committee	Mean	Std. Deviation	N. of companies with a Nomination committee	Mean	Std. Deviation	N. of companies with a Remuneration committee	Mean	Std. Deviation
Blue chips	67	6.57	4.03	9	4.44	3.78	60	2.95	3.13
STAR	40	4.33	2.47	8	1.13	0.99	36	1.61	1.48
Ordinario	62	3.74	2.57	9	1.44	1.24	51	1.29	1.14
Nuovo mercato	28	3.36	1.47	5	2.00	1.58	28	1.75	1.32
Expandi	2	3.50	4.95	-			-		
Total	199	4.75	3.29	31	2.32	2.60	175	2.00	2.21

5. Conclusions

The results of the analyses highlight many positive tendencies but also some persistent critical states in the governance structure of Italian listed companies. The analysis show that the majority of Italian listed companies declared to adopt the Corporate

Governance Code. However, if the information of the *Summary Report* is investigated in reference to the single recommendations of the Code, along with some positive trends we find some contradictory discrepancies that lead us to think that for some companies there is only a “formal” adhesion to the principles that inspired the Code.

Although it is true that a growing percentage of the listed companies appointed independent directors and established an Audit Committee, nonetheless there were also companies that declared their compliance to the Code but at the same time did not appoint any Independent Director. There were also companies whose Board of Auditors stated that the number of Independent Directors is not adequate.

Thus we can say that the appointment of independent Directors in Italian listed companies became a widespread practice, but we expect that all the companies that declare adherence to the Code will quickly and fully comply with its most important recommendations such as the appointment of independent directors and the establishment of the Audit Committee.

It is rather disheartening to find companies that formally established an Audit Committee but this Committee didn't hold any meetings during the whole year.

Another result which deserves to be taken into consideration concerns the number of meetings of the Audit Committee, which is on average too low considering the fundamental role that this Committee plays in carrying out the company auditing system. Generally in Italian listed companies' the Audit Committee meets 4 times a year. This fact, however has to be interpreted taking into account, on one hand, that also the Board of Auditors work in the control system of Italian companies and that, on the other hand, the number of meetings of the Committee tends to change according to the different market or segment of listing (it is normally higher in companies with an higher capitalization).

As regards to the information concerning the Board of Auditors, the analysis showed that there was a significant number of cases in which the Board of Auditors members declared to have a high number of appointments in listed and non listed companies. Another aspect that should be highlighted is the low number of Auditors that have been elected by minority shareholders.

However, the majority of the companies seem to have positively accepted the Corporate Governance Code and we cannot overlook the fact that some recommendations, for instance the establishment of Committees and the introduction of Independent Directors, represent a deep and substantial novelty in Italian companies. So, even though the empirical analysis showed some irregularities, we think that this could be due to a gradual compliance to the new framework. Further researches are needed to test other improvement in more recent years.

ACKNOWLEDGEMENTS

This paper is part of a broad research project financed by MIUR. The authors gratefully acknowledge MIUR and Consob for allowing the use of Summary Report data.

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