

# ITALIAN CORPORATE GOVERNANCE RATING MODEL: IS IT USEFUL IN TESTING ALL TYPES OF CORPORATE GOVERNANCE?

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## Abstract

In our empirical analysis the evidence found fully reflects the theoretical characteristics studied in small and medium-sized enterprises rather than large enterprises. The dominant role of the shareholder in small and medium-sized enterprises and the type of ownership composition and structure are fundamental. The analysis of multi-case studies, also, explains the higher scores obtained from the listed companies under the heading of Shareholders protection. These enterprises should be able to provide the means to communicate and should have greater ability to protect shareholders.

**Keywords:** Corporate Governance, Rating Model,

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## 1. Introduction

In the last few decades, the importance of the role played by corporate governance has emerged in several studies (Demb and Neubauer, 1992; Blair, 1995; Shleifer and Vishny, 1997; Kose and Senbet, 1998; Airoidi *et al.*, 1998; Salvioni, 2004; Ferraris Franceschi, 2005; Zattoni, 2006; Huse, 2007; Knight, 2008)<sup>1</sup>.

At the beginning of the 21th century, the issue of corporate governance grew in importance, limited, however, to the development of the role and functioning of the board of directors, primarily in listed companies.

In recent years, the concept of corporate governance has been further extended to cover not only the duties of the board of directors and its composition but also ownership as well as mandatory and voluntary regulation (Magli, 2011).

There are different definitions of corporate governance which are more or less exhaustive, but a more detailed notion is found in the Italian Code of Conduct (Corporate Governance Committee of Listed Companies, 1999) in which corporate governance is considered the system of rules and mechanisms by which companies are directed and controlled, the result of norms, traditions, behaviors developed by

economic and legal systems, certainly not due to a single model, exported and imitated in all jurisdictions.

Corporate governance has assumed great importance since the early 21<sup>st</sup> century (after Enron, Parmalat, and other corporate scandals) and now receives even more attention for three main reasons:

- the diffusion of privatization; this change in the enterprises' structure has raised corporate governance issues in sectors that were previously in the state's hands;

- technological progress, the opening up of financial markets, trade liberalization and other structural reforms; these changes make good governance, particularly transparency, important in order to provide investors with clear, comprehensive financial statements;

- managing the mobilization of capital is more complex, given the increasing size of firms, the growing role of financial intermediaries, and the proliferation of complex financial derivatives in investment strategies, which means multiple steps between the investor and the final user of that investor's capital; this increased delegation of investment has raised the need for good corporate governance arrangements. (Claessens and Yurtoglu, 2012:5)

According to Sherman (2004), the interest in corporate governance is cyclical; corporate governance has been an important issue since the public limited company were born in the 19<sup>th</sup> century,

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<sup>1</sup> The present contribution presents parts attributable as follows: Paragraphs 1, 2, 3, 4 and 5 are attributable to Francesca Magli, 6.1 and 6.2 to Matteo Ogliari and 7 to Alberto Nobolo

when for the first time there was a separation between owners of firms and the managers who run them.

Today, corporate governance should be a daily concern and not just something to be examined retrospectively when things go wrong.

## **2. The Structure of the Italian Market**

In an analysis of corporate governance from a cross-country perspective, the question arises whether a common, global framework is optimal for all. In fact, corporate governance systems have different features depending on the country concerned.

This issue is still evident more in the emerging market economies (for example China, India, Brazil) where the traditional model for corporate governance is not necessarily the framework that works best. Corporate governance must operate differently in these environments. These differences underscore the necessity for some level of adaptation of corporate governance principles, an area of increasing activity in recent reform efforts, and of much research interest (Claessens and Yurtoglu, 2012:4).

For this reason, in this contribution we analyze these differences in order to develop better the characteristics of typical Italian companies and Italian corporate governance.

The Italian industrial system is characterized by the presence of a few large companies and many small and micro-businesses.

This business typology is very important, because small and micro-businesses make up the vast majority of businesses, making a significant contribution to national economic vitality (Besser, 2012) and have an important role in contributing towards a stable and sustainable social and economic community environment (Samujh, 2008).

In a 2011 document of the US Small Business Administration (US SBA), small businesses are defined as for-profit enterprises with fewer than 500 employees. Small and medium businesses are defined as privately-held firms with 1-9 and 10-99 employees, respectively (Van der Wijst, 1989), firms with less than 100 employees and less than €15 million turnover (Jordan *et al.*, 1998) or with less than 200 employees (Michaelas *et al.*, 1999). The European Commission adopted, however, the definition for SMEs as firms with less than 250 employees, less than €50 million turnover and less than €43 million total assets (European Commission, 2003).

There is no univocal definition, but this type of company is generally the most widespread in most states.

In fact, small and medium-sized businesses represent 97% of the total number of firms in the OECD member states (Altaman and Sabato, 2007) and 99.9% of the 29.6 million businesses in the US (Besser, 2012).

In Italy, SMEs represent a percentage (99.9%) close to the EU average (99.8%). The majority are

micro-enterprises, which account for 94.6% of the total (European Commission, 2010).

With regard to corporate governance, in Italy, the enterprise governance system has two typical characteristics:

- the first concerns the combination of two fundamental aspects of governance such as the shareholding structure and the degree of stability of the structure;

- the second concerns the legislative model of governance adopted by the company.

Regarding the analysis of the governance model, the Italian company is strongly characterized by centralized and unitary ownership (in the figure of the entrepreneur) and by the stability of this. In terms of ownership concentration, the average share of the largest shareholder is 67%, the average share of the top three shareholders is 92%, the median number of shareholders is 3 (Bianchi *et al.*, 2006).

The Italian market can be distinguished by the high proportion of family businesses or "companies in which one or more families, linked by kinship or allied, holding a share of the capital likely to exercise control" (Montemerlo, 2000).

The family business is a type of company that exists in all parts of the world, but it is the most common form in the reality of Italian companies. One study shows that 85% of Italian companies are family businesses (Ravasi and Zattoni, 2000).

In addition to the quantitative aspects described, SMEs have some characteristic features of a qualitative nature, represented by:

- connection family-enterprise, with confusion between property and governance roles;

- centralization of management that assume a role of co-operation with the entrepreneur acting in the interest of the owner;

- presence in narrow competitive environments.

In Italy, then, many enterprises that are SMEs are also family businesses.

Among the models of governance introduced in Italy in 2003 alongside the traditional model, there are two additional governance models (monistic and dual systems). The traditional model is, nevertheless, still the favorite and the most adopted by Italian companies.

This system provides a management organ, appointed by the shareholders meeting, and termed the "board of directors" and a control organ as defined in the board of statutory advisors, also appointed by the shareholders.

This model is the best to split the function of control from that of management, control that is both legality and merit control. In the two-tier model, control is performed by the "supervisory board" while in the one-tier model by the "management control committee", no organ is in charge of the legality review.

It therefore seems that the traditional model ensures greater control and gives more representation to owners who are required to elect both the members of the management body (board of directors) and those of control organ (board of statutory advisors).

### **3. Corporate Governance Rating (CGR): Literature Review**

There are numerous studies on corporate governance and on the different mechanisms of governance (Demb and Neubauer, 1992; Blair, 1995; Shleifer and Vishny, 1997; Kose and Senbet, 1998; Airolti *et al.*, 1998; Becht *et al.*, 2002; Salvioni, 2004; Ferraris Franceschi, 2005; Zattoni, 2006; Huse, 2007; Hermalin and Weisbach, 2012) as well as on the relationship between good governance and performance.

The latter also analyzes the relationship between certain governance mechanisms and their impact on performance, and are studies on ownership structure (Fama and Jensen, 1983; McConnell and Servaes, 1990; Lauterbach and Vaninsky, 1999; Demstev and Villalonga, 2001; Weich, 2003), studies on the type of shareholder (Pound, 1988; Sharma *et al.*, 1997; Anderson and Reeb, 2003; Burkart *et al.*, 2003; Jaskeiwicz *et al.*, 2005; Danes *et al.*, 2007), studies on the size and the composition of the board (Hermalin and Weisbach, 1991; Yermack, 1996; Conyon and Peck, 1998; Eisenberg *et al.*, 1998; Agrawal and Knober, 1996; Coles *et al.*, 2001; De Andres *et al.*, 2005), studies on the presence of independent directors on the board (Bhagat and Black, 2002; Coles and Hoi, 2003; Giovannini, 2010) and studies on the duality (Berg and Smith, 1978; Fama and Jensen, 1983; Rechner and Dalton, 1989; Baliga *et al.*, 1996; Brichley *et al.*, 1997; Lazarides, 2009; Dalton and Dalton, 2010).

The term "corporate governance" appears as a key word in the abstract of 987 papers over the past year on SSRN, and, given the huge amount of research being done in the area, SSRN in 2009 started the Corporate Governance Network (CGN) with 21 different subject matter electronic journals (Bebchuk and Weisbach, 2009).

In the analysis carried out, we realized that there are gaps in the literature both in the corporate governance rating analysis and in the analysis of small and medium-sized enterprises.

The corporate governance rating analysis is a novel issue and, for this reason, little studied, as yet.

The concept of rating has different meanings depending on the country in which it is used. The English translation of the term "rating" is evaluation, but in Italy the word is almost always associated with credit (only lately has it been used to refer to corporate governance rating), and considering it purely a quantitative assessment.

Also for this reason, we can observe that there are no academic research papers or books that analyze

this issue but it is analyzed only in the publications of the rating agencies (Standard & Poor's, 2002; ICRA, 2004).

Regarding studies analyzing small and micro-businesses, until the late 1990s academics and policymakers neglected to research micro-businesses (Grenbank, 2000) in particular because access to small businesses is seen to be difficult (Lewis *et al.*, 2005).

Audretsch and Lehmann argue that there is only scarce evidence on corporate governance in small and medium-sized firms (Audretsch and Lehmann, 2011).

The same consideration is made by Gugler where he explains that in the analysis of comparison of identities of investors in 11 nations, in only two (Italy and France) were there studies on all firms and not only listed firms (Gugler, 2005).

Also, on the topic of the specific characteristics of governance (for example board composition), research focuses exclusively on large and mature organizations (Daily and Dalton, 1993; Dalton and Kesner, 1983) as compared to smaller or newer firms (Huse, 2000).

Another important criticism, linked to SMEs, concerns that many aspects of corporate governance are analyzed in SMEs but never the whole complex of corporate governance (Audretsch and Lehmann, 2011).

For these gaps and to analyze the entire population of Italian firms, without neglecting the most representative, we analyze not only listed companies but also SMEs.

### **4. Corporate Governance Rating Model Overview**

One of the most interesting tool to study and develop corporate governance is the rating system.

The Corporate Governance Rating (CGR) system born in the main credit rating agencies in order to identify quantitatively the quality and effectiveness of corporate governance.

Objective of CGR is to evaluate a company's business conduct, practices and disclosure standards quality in term of fairness and transparency from the prospective of its financial stakeholders (ICRA, 2004).

The greatest interest in some most ethical and accountability practices (good reporting practice, transparency, corporate social reporting, etc.) and wealth creation (long term equity, firm valuation, cost of borrowing analysis, etc.), due to economic and financial crisis, has further increased the interest in good corporate governance practices.

All over the world, rating agencies have arisen with the new task of assigning a rating to the system of corporate governance, highlighting merits and defects. The expansions of the stock market, the weight and size of institutional investors have all led to a diffusion of this service.

The most important key variables of corporate governance considered in CGR of the most important rating agencies are:

- Ownership structure;
- Governance structure with particular emphasis on board structure and processes;
- Stakeholder relationship;
- Financial transparency, ethical practices and information disclosure (ICRA, 2004; Standard & Poor's, 2002).

Considering the importance of the governance rating model, our study group has been involved in creating a more suitable model in order to better represent Italian companies.

To achieve the complete construction of our model we first made reference to the rating models used by the top rating agencies.

Examples of rating agencies that have developed rating systems on corporate governance are (Nobolo 2009):

1. Governance Metrics International (GMI),
2. Institutional Shareholders Services (ISS),
3. Standard and Poor's (S&P),
4. Corporate Library.

In the following table we can see how the rating systems offered by various agencies differ.

The rating scale is given in tenths or hundredths and all four agencies detect parameters that aggregate in seven (GMI and ISS) or four (S&P and Corporate Library) classes or areas.

**Table 1.** Rating System comparisons

Rating agency	Rating system	Information, source
Governance Metrics International (GMI)	Scale from 1 to 10 (1 = lowest, 10 = highest); 450 questions divided into 7 areas: board accountability, financial reporting and internal control, directors' remuneration, management control, reputation, socially responsible investment, corporate behavior, shareholders' rights.	Public documents (reports and prospectuses, press releases and company websites) and documents provided by the company and resulting from interviews with company management.
Institutional Shareholder Services (ISS)	Scale from 1 to 100 (1 = lowest, 100 = highest); 63 questions divided into 7 areas: board of directors structure and composition, internal and external audit; statute provisions, state laws, corporate information treatment; directors' remuneration; ownership. Rating calculated on the basis of two ratios: CGR industry and CGR index.	Public documents, such as reports and prospectuses, press releases and company websites.
Standard & Poor's (S&P)	Scale from 1 to 10 (1 = lowest, 10 = highest); 4 areas of interest: ownership structure and external influences, shareholders' rights and transactions with related parties, transparency and disclosure, board structure and effectiveness.	Public documents and interviews with CEO, directors of finance, corporate counsel, board of directors (chairman and independent directors), shareholders, company auditors.
Corporate Library	Scale: A, B, C ... 4 areas of interest: CEO compensation, board effectiveness, accounting and audit surveillance, the executive committee.	Public documents and interviews with managers and board members.

In our study of some parameters, in addition to the agencies mentioned above, we referred also to the rating model used by Standards Ethics and Deminor rating agencies.

## 5. Description of Corporate Governance Rating Model: Research Design

As already mentioned, corporate governance systems have different features depending to the country concerned.

In order to test the typical characteristics of corporate governance in Italian companies we developed a new Corporate Governance Rating (CGR) model.

Our rating model is different from others (Standards and Poor, Moody's, etc.), it draws greater attention to the features peculiar to the Italian governance system; there are, in fact, more information on family business characteristics, information on peculiar control organs of the traditional model of governance (not found in other scoring systems), more information on the transparency and on the protection of minority rights as set forth in the Code of Conduct for Italian listed companies.

The objective of the Corporate Governance Rating (CGR) is to analyze the goodness and the effectiveness of corporate governance. Here we will discuss the steps for building the model by identifying and defining all the variables considered important in the assessment of corporate governance.

The model<sup>2</sup> consists of 177 parameters, or metrics, which represent a summary of the management and governance procedures adopted by a company.

The three main categories analyzed are: ownership; governance; corporate disclosure.

Each of these categories is assigned a different weight in relation to the relevance for corporate governance and is divided into subclasses/sections.

**Ownership** - first category examines the company ownership structure and includes 56 questions/metrics grouped into 3 subclasses (table 2).

**Shareholder composition.** This section focuses on the structure of corporate stock and underlines the existence of shareholders' rights and powers. It shows the presence of a blockholder highlighting the number of shares owned. The analysis continues by checking the type of shares (ordinary shares, treasury shares, shares with special rights) and stresses any limits or conditions on their transfer or movement. The variables in the model investigate also the presence of shareholders' agreements within the company (indicating the quota value), the priorities in the distribution of profits and the possibility of hostile takeovers by analyzing the share of floating stock in the market.

**Shareholders' meeting.** This section contains a number of variables concerning the shareholders' meeting and, in particular, the presence of special voting majorities in the statute or qualified majorities for decisions relating to strategic plans or stock increases or the approval of long-term plans, high

financing operations and the ratification of any sales or acquisitions of shares in other companies.

**Shareholder protection.** This section includes a tools variables' set for increase investor confidence. The model assigns a positive score if, for example, the company adheres to a code of conduct, has meeting regulations, has adopted its own code of ethics and organizational model 231/2001<sup>3</sup>, and there is an investor relations section on the website.

**Governance** - The second category focuses on the analysis of the company governance structure, underlining the characteristics of various governing bodies and entities in charge of the audit. This category consists of 88 metrics divided into 7 sections: Board of directors; Executive committee; Control & Risk committee; Appointments committee; Remuneration committee; Board of statutory auditors; Auditors.

The table 3 shows the number of parameters contained in each section and the weights used for the assessment of governance.

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<sup>2</sup> The CGR model used for analysis is an evolution of the previous model presented to the XIV Annual Conference AIDEA Youth "L'azienda e i suoi stakeholder" Udine University, 26-27 giugno 2009 with the paper A. Nobolo, F. Arienti, F. Magli, *op. cit.*, 2009

<sup>3</sup> Legislative Decree 231/2001 has introduced into Italian law the obligation for legal persons to be held accountable for offences committed within its structure. The companies, however, can protect themselves by adopting and enforcing particular types of organization and internal management, such as the organizational model.

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**Table 2.** Rating System Ownership section

Section	Metrics no.	Weights
Shareholder composition	37	33.3%
Shareholders' meeting	8	33.3%
Shareholder protection	11	33.3%

Governance - the second category focuses on the analysis of the company governance structure, underlining the characteristics of various governing bodies and entities in charge of the audit. This category consists of 88 metrics divided into 7 sections:

- Board of directors;
- Executive committee;

- Control & Risk committee;
- Appointments committee;
- Remuneration committee;
- Board of statutory auditors;
- Auditors.

The table below shows the number of parameters contained in each section and the weights used for the assessment of governance.

**Table 3.** Rating System Governance section

Section	Metrics no.	Weights
Board of directors	35	35%
Executive committee	2	5%
Control & Risk committee	12	5%
Appointments committee	7	5%
Remuneration committee	14	5%
Board of statutory auditors	13	25%
Auditors	5	20%

*Board of directors.* This section looks at the board structure and is composed of many variables. The model investigates board composition (indicating the lead independent director if CEO and president coincide), the presence of family members on the board and the number of executive and independent directors. Also, if the number of CEOs and non-executive directors is more than the total of the executive, the model assigns a positive score. The section includes the number of meetings of the board of directors, board self-evaluation procedures, and limitations on the CEO's powers to attribute responsibilities and powers.

*Executive committee.* This section is composed of only two questions regarding its existence and number of committee meetings. If the last number is greater than the number of board meetings, the model will assign a score equal to 1.

*Control & Risk committee.* This is the essential governing body for an accurate assessment of business risks. The metrics analyzed committee composition (number of non-executive and independent directors), meeting participation, external auditors at meetings, presence of a procedure for identifying business risks and the appointment of a director of internal control.

*Appointments and remuneration committee.* The sections on these two committees are similarly structured. In addition to information about their composition and meeting participation, the most important metrics relate to company remuneration plans. The model, in fact, applies a positive score if there is a remuneration plan for directors, officers and

employees linked to the achievement of objectives and financial results or to stock option plans.

*Board of statutory auditors.* The sixth section present refers to the board of statutory auditors and provides metrics about the composition of this body and limits the accumulation of positions by the statutory auditors (also planned for administrators). Points of interest contained in this section refer to the mode of appointment of auditors and audit findings in the reports of the last three years. Regarding the appointment of auditors, the total score is positively affected if the list of candidates for the position is presented to shareholders owning at least 2.5% of stock, and with the presence at least one auditor elected by the minority (usually the chairman of the board and one substitute auditor). With regard to the auditor control tasks, however, the model assigns a negative score if, over the past three years, reports have highlighted significant reliefs and the auditors were changed before the expiry of the mandate.

*Auditors.* The supervisory accounting body in charge. A score of 1 is assigned if the auditors are an international network and they have obtained an extension of the office in the company in question. A negative score is assigned for a change of auditors in the first nine years (the legal maximum) and for the presence of limitations or exceptions in the reports made by the auditors.

Corporate disclosure - the third and final category covers corporate economic and financial communication and it is composed of 21 metrics contained within a single section. In particular, the highest score is assigned for the information that each

company provides on its website or within the various documents issued during the year. Among these we can list:

- statutes, semi-annual or quarterly financial reports;
- information on ownership;
- corporate bodies;
- share price;
- press releases;
- curricula and directors' remuneration;
- reports on corporate governance;
- section relating to shareholders meetings;
- "contacts" section.

In addition to this information, the model shows a number of metrics relating to the presence of procedures for internal dealing, management of confidential information and of transactions with related parties.

All parameters in the model play an important role in defining the structure of company governance; however, different weights report the greater significance of certain parameters more than others. For this reason, the first class, "Ownership", and the second class "Governance", get a weight equal to 40, while the last class "Information" gets a lower weight, equal to 20: this is due to mandatory disclosure of certain documents and information.

The treatment for the subclasses components of the model is the same.

### 5.1 Evaluation of the parameters

The evaluation types are:

- the simple insertion of the "value" of our interest. Examples are the detection of the stock share and the shares number;
- the presence or not of each typical characteristics of corporate governance (Yes=1 or 0/ No= 0 or -1), the negative score (-1) allows us to stress the negative elements that signal abnormalities;
- the "percentage evaluation" where a score is based on the percentage detected; for example: "share of the largest shareholder", in this case the share is compared with a benchmark;

- "numeric evaluation". In this type of assessment we compare a benchmark parameter considered of most importance with the value found in the companies under analysis (for example: "number of positions held by independent directors." If the number detected is <10 it is assigned score of 0; if the number, however, is >10 it is assigned a score of -1);

- "Statistical type", on the other hand, has been applied in the case of venture capital, and is evaluated by comparing it with the average of the companies in the sector to which it refers.

### 5.2 Penalization and average value

For each of the categories of the model we can calculate a maximum score and a minimum score obtainable, necessary in order to calculate an average value.

The average value indicates the presence of certain "requirements" in the governance structure. The introduction of the average value is born from the need to have a score in order to apply any penalty in the case where the score obtained by the company under analysis does not reach the expected value.

A score below average is a symptom of weakness, poor management and bad governance. For this reason, the model provides for the application of a penalty equal to 20% calculated on the average value of the section under analysis.

### 5.3 Rating classes

In our model we identified five rating class, in particular the rating class A is the highest score the entity can achieve, on the other hand the rating class E is the lowest score. We identified five class rating because consider it in line with the best practice and a simple and intuitive method to present the results obtained.

The table below shows the rating class used in our rating model.

**Table 4.** Rating classes

Class	Rating score
From 59 to 44	A
from 43 to 28	B
from 27 to 12	C
from 11 to (4)	D
From (5) to (20)	E

## 6. Multi-Case Study

In order to analyzes these differences and to prove the effectiveness of our new CGR model, the study will

continue with a multi-case study in which we will observe the different results of rating model in Italian family businesses, dividing the multi-case study into

small to medium-sized companies (typical of Italian business) and large listed companies.

Regarding methodology, primarily, we apply the model of governance to individual companies of the multi-case study analysis. Once we obtain the scores of governance, we can compare the rating results between the different companies to point out, also, the ability or not of the model to detect good governance in the companies not listed, with very different characteristics (especially regarding disclosures) from listed companies. For the listed companies, we will take as a reference the governance data published on the companies' websites, in particular corporate governance relations, while for the small and medium-sized enterprises, we use various published documents and the results of a survey sent to the managers of the company.

Main aim of our work is to investigate the ability of our rating model to highlight the effectiveness goodness of corporate governance, by analyzing not only the large and listed companies, with reporting and documentation requirements, but also of small and medium-sized companies. In particular, we expect that these latter firms, because of different mechanisms of governance and the diverse role of family ownership in the process of business growth, should produce the highest score of governance.

The companies analyzed in the context of our study are six family businesses: three medium unlisted and three large listed.

The sample is:

**Table 5.** Case studies

Listed Family Businesses	Unlisted Family Businesses
Boero Bartolomeo SpA	Maimeri SpA
Brembo SpA	Regina Catene Calibrate SpA
Interpump Group SpA	Peroni Pompe SpA

The selected companies can be compared horizontally according to the type of product/service offered. The first two can be categorized in Italian Stock Exchange sector 'Products for buildings and materials,' the second two in the 'Consumer' category because both produce motorcycles and related products, and the third in 'Industrial Goods & Services' because both produce industrial pumps.

## 6.1 Listed companies

### *Boero Group*

In Genoa in 1831, from a small factory for the production of white lead powder, Bartolomeo Boero starts the family business in coatings. Until the 19<sup>th</sup> century, white lead was the only inorganic pigment know and used to manufacture paints; the great durability of this raw material is shown by pictures and paintings centuries-old. The company develops rapidly, thanks also to its proximity to the city harbor and to the availability of easy and inexpensive transportation, which encourage commercial choices that were very innovative at that time. From 1982, Boero Bartolomeo S.p.A. is listed on the Italian Stock Exchange. The company has a traditional system of governance.

After many years of membership of the Code of Corporate Governance, Boero Bartolomeo S.p.A. decide no longer to adhere to the code. The company has evaluated the cases of deviation from the recommendations of the code with respect to cases of accession, considering for this unproductive effort thorough examination of all the provisions of the code and the specific explanation of the reasons for non-adherence. The company has shareholders who exercise control of law. The board of directors has not

established a committee. A lead independent director has not been established. . There are no succession plans. The corporate governance follows the provisions of the statute, which in turn repeat largely the statutory provisions related to the model of traditional administration adopted by the company..

### *Brembo Group*

Brembo S.p.A. is an acknowledged world leader and innovator in the field of automotive disk brake technology. The company supplies high performance braking systems to the premier makers of automobiles, motorcycles, and commercial vehicles worldwide, as well as clutches, seats, harnesses, and other components for the racing sector only. The company operates currently in 16 countries on three continents, with 22 production and business sites and a pool of human resources numbering around 7,000. Brembo operates in domestic and international markets according to the best practices in compliance applicable regulations and the Italian principles of governance, which was also held on account of their membership of the star segment of the Italian Stock Exchange. Brembo S.p.A. is listed on the Italian Stock Exchange. The company has a traditional system of governance.

The company has adhered to the Code of Corporate Governance of the Italian stock exchange. In line with the legal provisions of the Code of Corporate Governance relating to the model of management and control, the directors are appointed by list vote. There is a lead independent director and there are independent directors. In line with the recommendations of Code of Corporate Governance, control and risks, remuneration and nomination committees have been set up. The remuneration of

directors is indicated and declared in line with international practices.

#### Interpump Group

Interpump Group is a prominent global supplier of pumps, fluid handling components, agriculture & industrial spaying products, pressure washers, pressure wash accessories, and cleaning equipment. Established in 1975, Interpump Group operates on domestic and international markets according to the best practices in compliance applicable regulations and Italian governance principles. Since 2001, Interpump has been listed on the Italian Stock Exchange, which was also held on account of their membership of the star segment of the Italian Stock Exchange. The company has a traditional system of governance.

The ordinary shareholders' meeting approves the financial statements, appoints and cancels the directors, appoints the statutory auditors and the chairman of the board of statutory auditors,

determines the remuneration of directors and statutory auditors. In line with the legal provisions of the Code of Corporate Governance relating to the model of management and control, the directors are appointed by list vote. The remuneration committee and the control and risk committee in compliance with the Code of Corporate Governance have been composed from within the board of directors. Interpump Group has fully adapted its procedures to comply with the provisions of the Code of Corporate Governance issued under the patronage of Italian Stock Exchange starting from the resolution of the board of June 28, 2000, and with a resolution in February 2007, it has implemented the most recent amendments made to the Code in March 2006 and with a resolution of November 2012 the amendments made to the Code in December 2011.

The main results of corporate governance ratings analysis of listed companies are set out in the table below:

**Table 6.** Listed companies ratings

	Boero	Brembo	Interpump
<b>Ownership</b>			
Shareholder composition	(1)	3	(3)
Shareholder's meeting	2	1	5
Shareholder protection	12	18	21
Total	5	9	9
<b>Governance</b>			
Board of directors	9	10	9
Executive committee	(1)	(1)	(1)
Control & risks committee	0	3	5
Appointment committee	0	4	0
Remuneration committee	0	4	4
Board of statutory auditors	6	5	2
Auditors	4	8	12
Total	7	13	14
-			
Corporate disclosure			
Total	(2)	0	(1)
-			
Rating score	11	21	21
-			
Rating class	D	C	C

The analysis of the ownership section detects the following characteristics:

– regarding the "shareholder composition" section Interpump's negative rating for this cluster is mainly related to the possession of its own shares, the existence of a shareholders' agreement and to the shares owned by the control agreement; the shareholders' composition also allows possible takeover. The analysis on Boero shareholders' composition shows that the company does not have shareholders' agreement nor the possibility of takeover and has different kinds of shares instead. The

negative elements that affect the rating are, among others and like the Interpump case, the presence of own shares and the shares owned by the control agreement. With regard to the Brembo shareholders' composition, we noted that the major shareholder owns more than 50% of the shares and the company has own shares in its portfolio, but the presence of minorities, the presence of conditions and limitations on share circulation and the provision of a minimum of listed shares gives a positive rating to the company for this cluster;

– regarding “Shareholders meeting” all the companies in the sample obtain a positive score. Both Interpump and Brembo statutes include the provision of the approval of the financial statements by shareholders meeting in case of non-approval by the supervisory board. Interpump statute also defines only the quorum for shareholders meeting’s resolutions. Boero statute defines that a shareholders meeting has to ratify joint venture agreements and to approve the disposal or acquisition of shares on other investments and the approval for financing agreements exceeding a certain amount;

– the three companies have a positive rating regarding the “Shareholders protection” section; Brembo and Interpump have higher ratings for this cluster because, unlike Boero, they adopt the Code of Corporate Governance, have a shareholders’ meeting regulation, an investor relator and a dedicated section on the company website. Each company has a code of ethics and has adopted an organizational model 231/2001 and the list vote for the appointment of directors and of the statutory auditors. Boero has weaker mechanisms for shareholders’ protection; Interpump also presents weaknesses related to provisions for related parties transactions because it has significant transactions with related parties out of the consolidation perimeter and because it performs operations with related parties attributable to the shareholders.

The analysis of the Governance section notes the following peculiarities:

– considering the composition and the mechanisms that rule the board of directors, we noted some weaknesses such as the coincidence of the chairman with the CEO (Interpump) and the presence of family members on the board with operational delegations (Boero and Brembo), the performance of professional activity by the independent directors (Interpump and Brembo) and the accumulation of charges with other boards;

– we also noted that the three companies also have strengths that allow them to reach a positive rating such as the presence of independent directors, the frequency of meeting at least quarterly (Boero and Brembo), the presence of the lead independent director (Brembo), the meeting of the independent directors which takes place at least annually (Interpump and Brembo), the provision of exclusive and relevant matters to be discussed (Interpump and Brembo) and the ownership of shares by the directors and limits to the delegation in such matters (Interpump and Brembo);

– regarding committees, none of the three companies in the sample has an executive committee; this situation is weaker in companies like Interpump, in which the chairman and the CEO are the same person. Boero’s governance does not establish the control and risk committee; we consider the lack of this control mechanism a significant deficiency in the governance structure. Interpump and Boero have not

established an appointment committee, unlike Brembo which formed it with a majority of independent members; Boero has neither an appointments committee nor a remuneration committee. We noted that the three companies are not in line with the best practices which, even if these committees are not requested by law, have established their importance;

– regarding the board of statutory auditors, the weaknesses noted are the professional activity performed by the single statutory auditor (Interpump and Brembo) and the relevant number of appointments per single statutory auditor (Brembo).

The analysis of the “Corporate disclosure” section notes that none of the three companies of the sample obtains a positive rating related to corporate disclosure. They do not give information over and above that required by law and are not in line with those recommended by the best practices. The three companies disclose neither their management strategies nor the causes of the relevant biases from future plans. Brembo is in line with the requirements but it does not give additional information and does not issue information in line with best practice. Neither does it publish the register of people with access to privileged information. Interpump does not consider the exclusion of interested directors in resolutions in which interested directors are involved.

## **6.2 Unlisted companies**

### *Maimeri SpA*

Maimeri is an industrial and commercial paint colors factory founded in 1923 in Milan. Created by Gianni Maimeri with the help of his brother Carlo, industrial chemical, the first factory was built in 1936. In the following years, the hardships of war, the postwar reconstruction and the economic revival of the 1960s between innovation and market globalization, marked the path of the Brothers Maimeri Srl, when, in 1951, after the founder's death, the fate of the company was entrusted to Leone, his son. Leone, a person with great charisma and initiative, is responsible for the management of the delicate transformation from brilliant but small original business into a modern dynamic company. In 1974, the company was the first in Italy to construct a wastewater treatment plant as prescribed by law. Gianni Maimeri, son of Leone and grandson of the founder, has transformed the company into a public limited company, combining a deep passion for the family and the rapid growth of business. Since 1993, Maimeri has engaged in spreading the concept of quality Italian products around the world and successfully in Europe, Russia, and the United States and over 60 other foreign countries.

The blockholder is the grandson of the founder of the company with 65%, as well as its namesake, Gianni Maimeri. The board of directors is the only body responsible for the management and

administration of the family business and there is strong participation by the Maimeri family in the selection of board members. The board has five members: two are family members and three are independent directors. Both the CEO and the chairman of the board of directors are members of the family, but the two figures do not match. There are no committees. For the control, there is a board of statutory auditors but not a supervisory board 231.

#### *Peroni Pompe SpA*

Peroni Pompe S.p.A. was established in Milan in 1895 and has been manufacturing reciprocating pumps since the beginning of its activity. In the early 1950s, Peroni achieved significant results in the design and manufacture of pumps for the first area production pilot plant in the world (i.e. reciprocating pumps, centrifugal pumps, and piston engines, valves for industrial and civil applications). This brought Peroni success in the international market for this process application and in all the fields where high pressure is involved in continuous and heavy-duty applications. In the 1980s, Peroni was part of the Eni/Agip Group, which gave it the opportunity to expand its activity in the oil and gas market. In the 2008, Peroni Pompe headquarters moved to new premises including a state-of-the-art research center, located in the Milan area.

The main shareholder of the company is the holding company of the family, with 70%. This holding is composed entirely of members of the family; the major shareholders are the husband and wife of family with 55% of ownership, the rest is divided between three of the five children (45%). The composition of the board of directors for Peroni Pompe sees the husband chairman of the board and the son of the chairman as CEO and vice chairman.

#### *Regina Catene Calibrate SpA*

Regina Group is a world-leading developer and manufacturer of power transmission chains and related power transmission devices and components. Regina Group operates worldwide through fully owned commercial and manufacturing subsidiaries with strong local technical knowledge and a capillary network of distributors and agents. Regina was established in 1919 and was, initially, active in the production of chains and free wheels for bicycles, mopeds, and motorcycles. After World War II, Regina started to produce industrial chains, also for the international market. In 1956, Regina established Polimeccanica, a production subsidiary in Buenos Aires (Argentina), which is still operating today. In the 1990s, the group significantly developed internationally, entering the North American market, establishing Regina USA in Cambridge, MD and then establishing sales subsidiaries in Mexico, England, and France. In 2008, a production subsidiary for the manufacturing of industrial chains was established in Spain.

The main shareholder of the company is the holding company of the family with 51%. The share capital of the holding company is held by the chairman of the board of directors of Regina, Catene Calibrate spa (20%) and other family members, including, in particular two sons of the chairman each with 3.18%. There is a shareholders' agreement and the body of control is the board of statutory advisors.

The main results of the analysis of the corporate governance ratings of the unlisted companies are set out in the table below:

**Table 7.** Unlisted companies Ratings

	Maimeri	Peroni pompe	Catene Regina
<b>Ownership</b>			
Shareholder composition	5	3	10
Shareholder's meeting	17	13	17
Shareholder protection	3	0	9
<b>Total</b>	<b>10</b>	<b>6</b>	<b>15</b>
<b>Governance</b>			
Board of directors	10	10	12
Executive committee	(1)	(1)	(1)
Control & risks committee	0	0	0
Appointment committee	0	0	0
Remuneration committee	0	0	0
Board of statutory auditors	1	2	2
Auditors	4	4	8
<b>Total</b>	<b>6</b>	<b>6</b>	<b>9</b>
<b>Corporate disclosure</b>			
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Rating Score</b>	<b>16</b>	<b>13</b>	<b>23</b>
<b>Rating class</b>	<b>C</b>	<b>C</b>	<b>C</b>

Even though they are in the same rating range (C), the three companies obtain different scores ranging from 13 for Peroni Pompe to 23 for Regina Catene Calibrate.

The reasons for this deviation relate in particular to the "Ownership" section, where Peroni Pompe gets a lower score in all three sections (in the total score of the "Ownership" section, 6, compared to Maimeri's 10 and Regina Catene Calibrate's 15). The differences can be tracked to the presence in the two other companies of:

- pre-emption clauses and option rights in order to better protect the shareholder (in Shareholder composition section);
- ratification/signing of joint venture agreements, approval of multi-year strategic plans and approval of financing plans above a certain threshold (in Shareholder's meeting section);
- release with margin in advance (at least two days) of the relevant information of the board (in Shareholder protection section).

The "Governance" section score is the same for Maimeri and Peroni Pompe, higher for Regina. Regina's better score is due to the higher presence of independent directors and the increased frequency with which the board of directors meets (at least quarterly). Another important difference that increases Regina's score is that the blockholder carries out significant activities in corporate management. The presence or absence of committees does not influence the score as, not being obliged, none of the three unlisted companies formed committees.

The same consideration as regards information; unlisted companies do not have special obligations of public communication (the section "Corporate disclosure" is equal to zero for all three companies). The main evidences in the table above relates to the high scores in the "Ownership" section and the low score in the "Governance" section.

In the table below we analyse the comparison between the rating scores of the listed and unlisted companies:

**Table 8.** Listed and Unlisted companies Rating - Comparison

	Boero	Brembo	Interpump	Maimeri	Peroni pompe	Catene Regina
<b>Ownership</b>						
Shareholder composition	(1)	3	(3)	5	3	10
Shareholder's meeting	2	1	5	17	13	17
Shareholder protection	12	18	21	3	0	9
Total	5	9	9	10	6	15
<b>Governance</b>						
Board of directors	9	10	9	10	10	12
Executive committee	(1)	(1)	(1)	0	0	0
Control & risks committee	0	3	5	0	0	0
Appointment committee	0	4	0	0	0	0
Remuneration committee	0	4	4	0	0	0
Board of statutory auditors	6	5	2	1	2	2
Auditors	4	8	12	4	4	8
Total	7	13	14	6	6	9
- Corporate disclosure						
Total	(2)	0	(1)	0	0	0
- Rating score	11	21	21	16	13	23
Rating class	D	C	C	C	C	C

The main differences among the listed and unlisted companies is that the first report higher governance scores than the latter, and vice versa as regards the "Ownership" section.

The main reason, with regard to the low scores in the "Governance" section of the unlisted companies, concerns the non-compulsory nature of

establishing committees under the board of directors. These tools, instead, are suggested by the recommendations of the Corporate Governance Code for listed companies (*Codice di Autodisciplina*), in order to optimize the performance of the board of directors.

In the "Ownership" section we observe a totally different evaluation, especially in the assessment of the shareholder's meeting and shareholder protection. Regarding the shareholder's meeting, in unlisted companies, there is a higher rating score because there is more regulation and more tasks are designated to the shareholders, including for example:

- approval of multi-year plans for determining management policies;
- approval of the sale or acquisition of shares in other companies;
- forecasting statutory voting quorum.

Under the "Shareholder protection" section we observe, as we predicted, that the listed companies have higher scores than the unlisted companies. This is also motivated by the "Shareholder composition" section of the unlisted companies where there is a greater susceptibility to the personal liability of shareholders, to the internal relations and an increase in the clauses that protect the members of the control organs in relation to the shareholders. With regard to "Shareholder protection", in fact, listed companies develop more accurate documentation, complying with all those codes/regulations to ensure greater protection (such as the code of ethics, the Shareholder's regulation, the model 231, etc.).

## 7. Concluding Remarks

In our empirical analysis the evidence found fully reflects the theoretical characteristics studied in small and medium-sized enterprises rather than large enterprises.

The dominant role of the shareholder in small and medium-sized enterprises and the type of ownership composition and structure are fundamental (17-13-17 rating scores in the total "Ownership" section for the unlisted companies, as opposed to 2-1-5 rating scores for the listed companies).

The analysis of multi-case studies, also, explains the higher scores obtained from the listed companies under the heading of Shareholders protection. These enterprises should be able to provide the means to communicate and should have greater ability to protect shareholders (especially minority shareholders) in order to achieve greater confidence, trust, and funding (the rating result of Shareholder protection is 0 in Peroni - the lowest - compared with 21 for Interpump - the highest).

The management of the governance structure is less important for SMEs. This is quite obvious given that the majority shareholders are often the key members of the board of directors, and in our sample are just that.

Moreover, the difficulty of applying a single CGR model to the entire population of enterprises has been made clear. The inability to evaluate in the same way the presence of committees and the fact that communication may be mandatory for some companies and not mandatory for others (two

important parts of the CGR model) detracted from our ability to evaluate SMEs.

However, in a nutshell, from our empirical work, it seems that medium-sized businesses have obtained higher rating classes. Three medium-sized enterprises have obtained C class while only two large and listed companies got C class and one D class.

It, therefore, seems that the medium-sized enterprises have been able, maybe because of the different mechanisms of governance and the changing role of the family owners, to produce a higher Corporate Governance Rating (CGR) score.

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