

ITALIAN ASSET MANAGEMENT COMPANIES: PRODUCTS AND GOVERNANCE

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Abstract

The importance of the asset management sector has prompted many studies to highlight the need to promote its growth and development. This is even more so following the recent financial crisis, considered by many authors the most severe recession after World War II. Contributions existing in literature have emphasized the importance of investigating the corporate governance system of the Asset Management Companies (AMCs), considering that the Italian financial system is characterized by a "vertical integration" between production and distribution. In particular, the purpose of our research is to establish whether the products offered by Italian AMCs affect their governance structure. We use a statistical multi – equation method called Seemingly Unrelated Regression (SUR) and analyze the period 2006-2010. Results show that mutual fund categories offered by Italian AMCs are very important because they may affect their corporate governance system and, therefore, the Italian asset management market.

Keywords: Asset Management Companies (AMCs), Mutual Funds, Corporate Governance

JEL Classification: G15, G23, G32

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1. Introduction

Recent financial crisis has contributed to determine a radical change in business environment. This situation had some consequences in terms of necessity to increase innovation and competitiveness of companies.

Also the asset management, in Italy and abroad, suffered from this tricky period, so it appears important to study this sector, paying attention to the asset management companies (AMCs, the Italian *Società di gestione del risparmio*). In particular, we investigate the products they offer and their governance structure.

Corporate governance (CG) is a widely debated topic and it is more relevant to the context of asset management (Stoughton et al., 2011). In Italy, asset management is characterized by two "distortions": a *vertical integration* between production and distribution and the predominance of AMCs belonging to banking or insurance groups. Messori (2008) finds that the potential conflict of interest characterizing the Italian asset management sector probably determined the decline, which means that it is important to promote the improvement of corporate governance system of asset managers.

Considering that good corporate governance promotes value creation, development and economic growth, this study examines the products offered by AMCs and their governance structure during the period 2006 – 2010. In particular, the aim of the paper is to establish whether mutual fund categories affect the governance system of AMCs.

The rest of the paper proceeds as follows. In the next section we present a literature review on the Italian asset management sector, corporate governance and management companies. Section Three and Four describe the statistical methodology and the results of the empirical analysis. Finally, in the last section we present the conclusions.

2. Literature review

Asset management is a very important sector for the Italian financial system. Numerous studies, among which Stoughton et al. (2011), have highlighted the need to foster growth and development of this industry. This even more so following the recent financial crisis, considered the most severe recession after World War II.

Crisis has made necessary to intervene in several directions: risk monitoring, long-term savings and retirement planning, regulation, investor protection, cost competitiveness and

corporate governance. A very important consideration in the asset management sector is the following: good corporate governance is necessary to ensure investor confidence (Klapper and Love 2004; Himmelberg et al. 1999). The issue is particularly important in the light of national⁷ law and European⁸ directives based on client interest protection and reduction of potential conflict of interest. Asset management is the sector where intermediaries take decisions in the name and on behalf of clients. Therefore it is fundamental to assess the structure and organization of their main Italian protagonists, the AMC's (Lener 1999).

Italian asset management sector has the following peculiarities: most AMC's belong to banking or insurance group and a *vertical integration* exists between production and distribution. This means that the supply model of asset management products is essentially based on the banking networks of the same group of AMC's. In other words, the same distribution channel often offers the asset management products to customers as an alternative to other financial instruments. It follows a potential conflict of interest.

Many contributions (Lener, 2005; La Porta et al., 1997, 1998) have stressed the importance to investigate the possible consequences of ownership of asset managers. Other authors (Walter, 1999; Burkart et al., 2003; Boot et al., 2006) describe the costs and benefits of the governance system. Moreover, some studies (Weisbach, 1988; Borokhovich et al., 1996; Khorana et al., 2007) deal with the different governance mechanisms.

The analysis of the governance characteristics is even more significant if we consider that AMC's are exposed to agency problems (Jensen and Meckling, 1976) and, also, to the *fund governance*, that is the potential conflict of interest between their members and the participants to the funds they manage.

In general, corporate governance is a key element for development and economic growth (OECD, 2004). It is the system by which the interests of multiple stakeholders are represented or the system by which companies are directed and controlled. Literature (Aguilera, 2005) distinguishes between the Anglo-Saxon and European model of corporate governance (Millstein, 1998). The first one is aimed to maximize the shareholder value, the latter considers the company as a combination of its stakeholders interests.

It is also possible to provide a restricted and a broad definition of corporate governance. It could be considered the set of relationships between

managers, directors and shareholders or the set of laws, regulations and practices of the private sector through which corporations can attract capital, conduct its business and generate profits. Finally, Shleifer and Vishny (1997) identify the CG as the way thanks to which the lenders are assured of getting a return on their investment.

A wide literature investigates governance characteristics, first of all the presence of a large number of independent directors (Hermalin and Weisbach 1998, 2003). *Outside independent director* is a director without managerial authority and significant relationship with the company and its group. In the AMC's, the independent director guarantees the interests of subscribers to the fund as well as minority shareholders.

Independent directors have several tasks: to check the correct application of procedures relating to the exercise of administrative charges related to financial instruments attributable to assets under management; to express an opinion on issues brought to their attention by at least two members of the board and to form an opinion on the adequacy of content and responsiveness to the interests of customers of the conventions that affect in some way on assets under management, to evaluate the criteria set by the board of directors for the remuneration of its members, the managers and the senior management. Despite their important functions, independent directors continue to be few within the decision board of AMC's. Moreover, board of directors is often made up by persons who have others executive functions within the groups.

The analysis of board composition requires considering another aspect: the separation between the president and the chief executive officer (Brickley et al., 1997). In general, it is preferable to avoid the so-called *Ceo duality*, that is the overlap of the two charges in the same person (Conger et al., 1998, Dalton and Daily, 1998, Donaldson and Davis, 1991). *Ceo duality* determines, in fact, an excessive power concentration in the hands of the same person.

Another important variable of governance is the number of shareholders. The theory of value creation for the shareholders argued that the maximization of shareholder value determines the maximization of the overall value created by the company and that the goal of maximizing the shareholder value allows to regulate the management. According to agency theory, there is a direct relationship between the degree of concentration and shareholder value creation.

It was demonstrated that the ownership structure is a complex variable, so that it should also investigate the nature of the parties which own significant shares of the capital firm.

Italian asset management industry is characterized by the lack of individual listed asset management companies, but, rather, the

⁷ Savings Law (Law No. 262 of 28 December 2005)

⁸ MiFID (Directive 2004/39/EC on Markets in Financial Instruments) and UCITS III (Directives 2001/107/EC and 2001/108/EC) and UCITS IV (Directive 2009/65/EC).

banking/insurance groups to which the AMC's belong are listed on regulated markets.

We have addressed the issue of corporate governance, it is, also, very important to pay attention to products offered by AMC's. In Italian asset management sector, products appear to be particularly subordinated to distribution: banking and insurance groups have a dominant role in mutual funds. Some researchers note that bigger AMC's tend to pay higher commissions than smaller AMC's to the distribution network (Bianchi e Miele, 2011), so that advantages deriving from AMC's size cannot be assigned to final clients. Several studies (Cremers and Nair, 2005) delved into the interaction between governance measures and firm performance, but results are not unanimous. Some researchers note that banking shareholding positively influences company profitability (Cable, 1985; Gorton and Schmid 2000), others did not find significant differences (Chirinko and Elston 2006).

3. Methodology

Our analysis is based on the study of the governance structure of Italian AMC's and their products. We selected Italian AMC's associated with the Italian asset management association, Assogestioni, during the period 2006 – 2010. In

particular, the empirical analysis was conducted on a sample of 74 AMC's, representing more than 50% of the sector in terms of assets under management. AMC's we have considered mainly belong to banking or insurance groups. We obtained two subsamples for each year, consisting respectively of independent and banking or insurance AMC's. It is important to define our concept of "independence": it is derived from Art. 2359 of the Italian Civil Code, where it states that "Significant influence is presumed when at least one fifth of the votes (or one tenth of the votes in listed companies) can be exercised in the shareholders' meeting". Therefore, for our purposes, an AMC is not independent if the overall banking or insurance shareholding is 20% or higher: in this case, AMC is linked to the distribution network.

The aim of our study is to verify whether the type of product on offer affects AMC governance structure. We consider different classes of mutual funds as independent variables of our analysis. Assogestioni classify mutual funds as: equity, bond, liquidity, balanced, flexible, hedge funds and real estate. We use the categories shown in Table 1, tested at 31 December each year.

Table 1. Mutual funds variables

Variable	Abbreviation
1) Equity mutual funds	(Equity)
2) Balanced funds	(Balanc.)
3) Bond mutual funds	(Bond)
4) Liquidity funds	(Liqu.)
5) Flexible funds	(Flex.)
6) Hedge funds	(Hedge)
7) Real estate funds	(RE)

For completeness, we include in our analysis two additional independent variables: ownership⁹ (Own.) and the annual market share¹⁰ of the AMC's, to take into account the asset management company size.

Dependent variables of our analysis are governance characteristics of Italian AMC's, tested at 31 December each year (Table 2).

⁹ Ownership is a dummy variable: it is 1 when AMC belongs to banking or insurance group and 0 when AMC is independent.

¹⁰ Market share was calculated by dividing the annual amount of assets managed by each AMC for the gross assets under management in the sector.

Table 2. Corporate governance variables

Independent variable	Abbreviation	Description
Number of shareholders	Shareholders	
Number of directors	Directors	
Number of independent directors	Ind. Directors	
Number of directors with other offices within the AMC's group	Other Offices	
Coincidence between the President and Ceo	Ceo duality	dummy variable with value 1 if the two charges are covered by the same person, 0 if there is no coincidence.
Membership of the management company to a listed group	Listed group	dummy variable with value 1 if the AMC belongs to a listed group, 0 otherwise.

The AMCs sample size and the proportion of the two subsamples change over the time period, because of mergers and acquisitions. In light of this consideration, we use a particular statistical methodology called *Seemingly Unrelated Regression (SUR)* and formulated by Zellner (1962, 1963). The *SUR* technique is applied to economic models that may have multiple equations apparently independent of each other and it enables us to estimate the equation jointly makes the estimators of the coefficients more efficient than least squares estimators of the single-equation. One of the potential benefits of the *SUR* methodology is that it incorporates the cross-section estimates of the residues in the estimated coefficients and statistical tests. The regression coefficients in all equations are estimated simultaneously by applying the Aitken's generalized least squares (GLS) to the

whole system of equations. The Aitken's estimators are constructed thanks to an estimate of variances and covariances of the disturbance terms, based on the residues resulting from application of least squares according to logic equation by equation.

Mathematically:

$$y_{\mu} = X_{\mu}\beta_{\mu} + u_{\mu} \quad (1)$$

we suppose that the (1) is the μ -th equation of an M equation regression system with y_{μ} ($T \times 1$) vector of observations on the μ -th "dependent" variable, X_{μ} ($T \times l_{\mu}$) matrix with rank l_{μ} of observations on l_{μ} "independent" non-stochastic variables, β_{μ} ($l_{\mu} \times 1$) vector of the regression coefficients and u_{μ} ($T \times 1$) vector of random error terms, each with mean zero. The system, of which (1) is an equation may be written as:

$$\begin{bmatrix} y_1 \\ y_2 \\ \vdots \\ y_M \end{bmatrix} = \begin{bmatrix} X_1 & 0 & \cdots & 0 \\ 0 & X_2 & \cdots & 0 \\ \vdots & \vdots & \ddots & \vdots \\ 0 & 0 & \cdots & X_M \end{bmatrix} \begin{bmatrix} \beta_1 \\ \beta_2 \\ \vdots \\ \beta_M \end{bmatrix} + \begin{bmatrix} u_1 \\ u_2 \\ \vdots \\ u_M \end{bmatrix} \quad (2)$$

$$y = X\beta + u \quad (3)$$

where $y = [y_1' y_2' \dots y_M']$, $\beta = [\beta_1' \beta_2' \dots \beta_M']$, $u = [u_1' u_2' \dots u_M']$ and X represents the block diagonal matrix on the right side of (2). It is

assumed that the M ($T \times 1$) disturbance vector in (2) and (3) is assumed to have the following variance-covariance matrix:

$$\Sigma = V(u) = \begin{bmatrix} \sigma_{11}I & \sigma_{12}I & \cdots & \sigma_{1M}I \\ \sigma_{21}I & \sigma_{22}I & \cdots & \sigma_{2M}I \\ \vdots & \vdots & \ddots & \vdots \\ \sigma_{M1}I & \sigma_{M2}I & \cdots & \sigma_{MM}I \end{bmatrix} = \begin{bmatrix} \sigma_{11} & \sigma_{12} & \cdots & \sigma_{1M} \\ \sigma_{21} & \sigma_{22} & \cdots & \sigma_{2M} \\ \vdots & \vdots & \ddots & \vdots \\ \sigma_{M1} & \sigma_{M2} & \cdots & \sigma_{MM} \end{bmatrix} \otimes I \quad (2)$$

$$= \Sigma_e \otimes I,$$

where I is a matrix of order $T \times T$ and $\sigma_{\mu\mu} = E(u_{\mu t} u_{\mu t})$ for $t = 1, 2, \dots, T$ and $\mu, \mu' = 1, 2, \dots, M$.

In temporal cross-sectional regressions, t is the time and (3) implies constant variances and

covariances from period to period, as well as the absence of any autocorrelation or serial correlation of the disturbance terms. Formally, we regard at (2) or (3) as a single-equation regression model and

apply Aitken's generalized least-squares. That is, we pre-multiply both sides of (3) by a matrix H which is such that $E(Hu'H') = H\Sigma H' = I$. In terms of transformed variables (the original variables pre-multiplied by H), the system satisfies the assumptions of the least squares model. The application of least squares will yield a best linear unbiased estimator (the estimator of Aitken's

generalized least squares) (The quadratic form that we have to minimize in the Aitken's approach is not the sum of the squares of the originating disturbances terms, but the processed noises. This makes the Aitken's estimator more efficient than classical least squares estimator based on the original variables), which is:

$$b^* = (X'H'HX)^{-1}X'H'H y = (X'\Sigma^{-1}X)^{-1}X'\Sigma^{-1}y. \quad (5)$$

In constructing this estimator, we need the inverse of Σ , which is given by:

$$\Sigma^{-1} = V^{-1}(u) = \begin{bmatrix} \sigma^{11}I & \dots & \sigma^{1M}I \\ \vdots & & \vdots \\ \sigma^{M1}I & \dots & \sigma^{MM}I \end{bmatrix} = \Sigma_c^{-1} \otimes I. \quad (6)$$

The Aitken estimator of the coefficient vector is:

$$b^* = \begin{bmatrix} b_1^* \\ b_2^* \\ \vdots \\ b_M^* \end{bmatrix} = \begin{bmatrix} \sigma^{11}X_1'X_1 & \sigma^{12}X_1'X_2 & \dots & \sigma^{1M}X_1'X_M \\ \sigma^{21}X_2'X_1 & \sigma^{22}X_2'X_2 & \dots & \sigma^{2M}X_2'X_M \\ \vdots & \vdots & \ddots & \vdots \\ \sigma^{M1}X_M'X_1 & \sigma^{M2}X_M'X_2 & \dots & \sigma^{MM}X_M'X_M \end{bmatrix}^{-1} \times \begin{bmatrix} \sum_{\mu=1}^M \sigma^{1\mu}X_1'y_\mu \\ \vdots \\ \sum_{\mu=1}^M \sigma^{M\mu}X_M'y_\mu \end{bmatrix} \quad (7)$$

4. Results

Tables 3- 7 show the results of our analysis. During the whole period from 2006 to 2010, banking and insurance AMCs had a lower number of shareholders and also they belong to a listed group. This could have consequences in terms of the size of the offer and demand segment reached by the products of the company management.

Moreover, the CEO duality more often characterizes independent AMCs: normally, they are, on average, smaller, therefore, they may have decided, in general, to adopt a simplified governance structure. This would seem consistent with the significance of the variable "Number of directors with other offices within the group of the AMC": banking and insurance AMCs appear to be characterized by a smaller number of such directors.

The main aim of our research is to try to understand if asset management products affect the governance structure of AMCs. Empirical analysis allows us to state the following. AMCs offering for sale real estate funds more often belong to a listed group. Moreover, they seem to have a greater number of independent directors from 2008 to 2010. This governance characteristic is becoming

very important in the last years. Equity funds are offered by AMCs having a lower number of shareholders from 2007 to 2010. This kind of mutual funds were offered at the beginning of the analyzed period by AMCs belonging to a listed group. Also balanced funds seem to affect governance of AMCs: management companies, essentially, have a lower number of shareholders and a higher number of directors. In recent years, these AMCs also showed a lower number of independent directors. The same consideration can be made for AMCs that offer to their clients bond mutual funds. This kind of mutual funds are mainly offered by management companies which are not listed. Also liquidity funds affect governance structure. Usually, they are offered by AMCs having a higher number of shareholders. Also they are not characterized by CEO duality. On the contrary, in the recent years, companies offering flexible funds, generally, showed CEO duality and a lower number of independent directors. Finally, we examined hedge funds to find their influence on governance variables. We note that they are offered by AMCs having a lower number of shareholders and independent directors. Moreover, these AMCs are characterized by CEO duality.

Table 3. SUR - relationship between mutual funds and CG (2006)

	Shareholders		Directors		Ind. Directors		Other Offices		CEO duality		Listed group	
	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value
Equity							0.034	***			-0.438	**
Balanc.	-0.023	**	0.012	**								
Bond							0.016	*			-0.399	***
Liqu.	0.032	***	0.006	*								
Flex.												
Hedge							0.018	***	0.146	*		
Real			-0.002	*			-0.014	**			0.111	**
Own.	-0.10	**									0.349	**

Table 3 shows the estimated coefficients, using the SUR method, of the independent variables (mutual funds categories), indicating the significance at 1% (***), 5% (**), 10% (*), the governance variables and the year (2006).

Table 4. SUR - relationship between mutual funds and CG (2007)

	Shareholders		Directors		Ind. Directors		Other Offices		CEO duality		Listed group	
	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value
Equity	-0.011	*					0.026	***			-0.515	***
Balanc.	-0.019	*	0.015	**			-0.053	**			-0.942	**
Bond											-0.355	**
Liqu.	0.029	***							-0.399	**		
Flex.												
Hedge	-0.003	*							0.149	***		
Real Estate			-0.002	*							0.105	**
Own.	-0.008	**					-0.01	**	-0.167	*	0.337	**

Table 4 shows the estimated coefficients, using the SUR method, of the independent variables (mutual funds categories), indicating the significance at 1% (***), 5% (**), 10% (*), the governance variables and the year (2007).

Table 5. SUR - relationship between mutual funds and CG (2008)

	Shareholders		Directors		Ind. Directors		Other Offices		CEO duality		Listed group	
	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value
Equity	-0.021	***			-0.032	*					-0.591	**
Balanc.	-0.039	**	0.015	*			-0.082	***	-0.845	*		
Bond											-0.444	***
Liqu.	0.017	***	0.005	*					-0.301	*		
Flex.					-0.034	**			0.258	*		
Hedge	-0.008	***	-0.002	**	-0.021	***			0.099	*	-0.178	**
Real Estate					0.019	***					0.168	**
Own.	-0.007	**									0.319	**

Table 5 shows the estimated coefficients, using the SUR method, of the independent variables (mutual funds categories), indicating the significance at 1% (***), 5% (**), 10% (*), the governance variables and the year (2008).

Table 6. SUR - relationship between mutual funds and CG (2009)

	Shareholders		Directors		Ind. Directors		Other Offices		CEO duality		Listed group	
	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value
Equity	-0.018	*							-0.397	*		
Balanc.	-0.049	*	0.022	**	-0.081	***						
Bond					-0.028	***			0.326	**	-0.538	**
Liqu.	0.015	*			0.017	*						
Flex.					-0.020	***			0.582	***		
Hedge	-0.014	***			-0.021	***			0.186	**		
Real Estate					0.022	***			-0.168	*	0.244	*
Own.	-0.009	**									0.323	**

Table 6 shows the estimated coefficients, using the SUR method, of the independent variables (mutual funds categories), indicating the significance at 1% (***), 5% (**), 10% (*), the governance variables and the year (2009).

Table 7. SUR - relationship between mutual funds and CG (2010)

	Shareholders		Directors		Ind. Directors		Other Offices		CEO duality		Listed group	
	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value	Coeff.	P-value
Equity	-0.029	***							-0.399	**		
Balanc.					-0.033	**					-0.663	*
Bond												
Liqu.	0.0258	***			-0.024	***			-0.304	*	-0.543	**
Flex.					-0.027	**			0.592	***		
Hedge	-0.013	***	-0.005	**	-0.026	***			0.193	**		
Real Estate					0.018	***					0.306	**
Own.	-0.011	***	-0.003	**			-0.011	*			0.388	***

Table 7 shows the estimated coefficients, using the SUR method, of the independent variables (mutual funds categories), indicating the significance at 1% (***), 5% (**), 10% (*), the governance variables and the year (2010).

We subjected the empirical analysis to Test F and obtained the following result:

$$F(28,1288) = 3.86222 [0.0000].$$

Empirical analysis shows that the kind of asset management products on offer affects the governance structure of AMCs.

5. Conclusion

The asset management industry is undergoing a profound transformation, also following the recent financial crisis. The turbulent environment enforces academics and practitioners to generate insight for doing business, so it appears important to study the asset management protagonists. Our study focused on asset management companies, which are very important intermediaries of the Italian asset management sector. In particular, the research aimed to verify if products offered for sale affect governance system of AMCs, during the period from 2006 to 2010. We considered the following governance variables: number of shareholders, directors, independent directors, directors with other offices in the AMC's group, CEO duality and membership of the management company to a listed group.

Empirical results show that a link exists between the two analyzed aspects. All mutual funds categories seem to affect some governance characteristics. This become more important in light of previous literature, stating that a better corporate governance determines development of an efficient asset management industry. We conducted our analysis considering the ownership of AMCs, by distinguishing AMCs belonging to banking or insurance group and independent AMCs.

In conclusion, the study could provide a contribution to the debate, existing in the academic and operational context, about the distinctive features of the asset management companies with a close connection between production and distribution. This is even more interesting, in the light of the Italian context of asset management,

which is characterized by the prevalence of non-independent AMCs.

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