

THE SLATE-VOTE SYSTEM AS A MECHANISM TO MITIGATE THE RISK OF SELF-DEALING TRANSACTIONS VIA RPTS

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Abstract

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Many corporate scandals shed new light on the risks associated with related party transaction (RPT), increasing the suspicious attitude and the negative perceptions that generally accompany these operations. In particular, in a high ownership concentration setting – as the Italian market – RPTs could be used by majority shareholders to tunnel resources, stimulating an undue appropriation of private benefits of control to the detriment of minority shareholders (self-dealing transactions). This paper contributes to the existing literature, analysing the slate-vote system's impact on the risks related to RPTs that pursue opportunistic purposes. The study aims to investigate the role that this corporate governance mechanism plays on the strictness of procedures and transparency of RPT disclosure, in the Italian institutional setting. More specifically, it identifies the anti-tunneling tools to protect minority shareholders aimed to prevent harmful transactions (ex-ante screening mechanism) and monitor the quality of RPT information conveyed to the market (ex-post screening mechanism). The analysis of an explanatory Italian case study offers an opportunity to gather evidence on the costs of these transactions and the role of minorities in fairness and transparency of the RPT procedure.

Keywords: Self-Dealing Transactions, Non-Controlling Shareholders, Minority Directors, Tunneling, Slate-Vote System, Related Party Transaction

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1. INTRODUCTION

After the most recent accounting scandals of firms that shook the financial markets, related party transactions (RPTs) proved to be one of the main issues that fuel the debate on corporate governance. Enron, Adelphia, and Parmalat crises shed light on the inherent risks, as related party transactions emerged as a powerful instrument of financial frauds, shareholders' expropriation, turning the veil from the many relevant loopholes affecting existing requirements (Pizzo, 2013). More in general, these

deals between an entity and one (or more) of its related parties could mask the interest to the enrichment of one party at the expense of others not directly involved in the transaction (Nekhili & Cherif, 2011). However, not all RPTs entail a value-expropriation. In some cases, they can serve as a value-enhancing effect through lower transaction costs, efficiency, and ease of enforcing property rights and imperfect contracts in as called propping hypothesis (Coase, 1937; Khanna & Palepu, 1997; Shin & Park, 1999; Fan & Goyal, 2006; Wong & Jian, 2003).

In contexts characterized by a high ownership concentration— such as the Italian market – the risk value extraction via RPT can increase.

More specifically, RPTs could be used by majority shareholders to appropriate private benefits of control to the detriment of minority shareholders, with a negative impact on the firm value (Pizzo, Moscariello, & Vinciguerra, 2010). In this scenario, the separation between control rights and cash flow rights and the widespread use of control enhancing mechanisms (such as pyramids, shareholders' agreements, and dual-class actions), increase the risk of inefficient self-dealing transaction (Shleifer & Vishny, 1997; Faccio & Lang, 2002; Federowicz & Aguilera, 2003; Gospel & Pendleton, 2005; Thomsen, Pedersen, & Kvist, 2006; Sancetta, Cucari, & Esposito De Falco, 2018).

Indeed, without sufficient legal deterrents, allowing the company to deal with the controller's related parties represents a strong incentive to majority shareholders to tunnel resources out of the firms and to transfer corporate wealth to firms in which they have a majority ownership position (Johnson, La Porta, Lopez-de-Silanes, & Shleifer, 2000). More specifically, RPTs can be instrumental in depriving the company and investors of profit (cash-flow tunneling) and productive assets or the pro-rata value of their claim to such assets (asset tunneling).

The strengthening and recognizing minority rights by the appointment of minority directors on the board could stem the risk of undue value expropriation.

This substantial attempt of board's democratization has been introduced in Italy as a slate-vote-system becoming a peculiar feature of the current Italian corporate governance (Law No. 262 of 28 December 2005; Malberti & Sironi, 2007; De Poli & De Gioia Carabellese, 2017; Bianchi, Enriques, & Milic, 2018), emerging as a leading example for the adoption of corporate governance instruments able to stimulate shareholders' activism (Zingales, 2008; Ventoruzzo, 2010; Esposito De Falco, 2017).

Thus, the abandonment of the single-winner model in favour of a new multiple election system, in which the Board members are also the expression of the will of the minorities, represents a mechanism to reduce the principal-principal conflict by compressing agency costs with a positive impact on firm value.

The minority directors represent the fundamental player in the boardroom able to carry out a procedural screening of RPTs (Paccès, 2018). In particular, they might prevent the corporate controller from adopting opportunistic behaviours and protect minority shareholders from the discretionary of the block-holder (Cappellieri, Moscariello, & Pizzo, 2019).

These high-risk transactions are disciplined by a peculiar Regulation that attempts to limit self-dealings and to protect investors.

RPT Regulation does not intend to prohibit or limit this type of transaction that represents only one of the many techniques that controllers can use to enrich themselves at the expense of their company, its minority shareholders, and other stakeholders (Enriques, 2014). An effective ban would shift tunneling to other techniques.

In contrast, it represents an attempt to guarantee the substantial and procedural fairness of related party transactions and improve the transparency of RPT disclosure, mitigating information asymmetry.

This paper carries out a critical survey on the impact that the presence of minority directors could exercise on RPTs entered with opportunistic purpose, analysing the role that the mechanism plays on the strictness of procedures and transparency of RPT disclosure, in Italian institutional setting.

The remainder of this paper is organised as follows. Section 2 carries out a critical review on RPT definition, analysing the hypothesis of the conflict of interests and the efficient transactions, introducing a contingency perspective to draw a clearer picture of RPTs' issue. Section 3 illustrates legal mechanisms against tunneling via RPTs, focusing on RPT discipline (Sub-section 3.1) and the regulatory framework for minority directors (Sub-section 3.2), in the Italian setting. In Section 4, the analysis of Parmalat - Lactalis case study leads to a reflection on the significant role of minority shareholders in these transactions. Section 5 describes the impact of the presence of minority directors on RPTs. Section 6 is the conclusion.

2. LITERATURE REVIEW

The role of RPT is central to the literature debate, considering conceptual difficulties in defining and measuring its consequences.

The literature and standard setters have provided several proper definitions of RPTs.

FASB (1982) has described RPTs as transactions between a company and related entities as subsidiaries, affiliates, principal owners, officers, and directors.

Following European International Accounting Standards, RPTs have to be intended to as a transfer of resources, service, or obligations between a reporting entity and a related party, regardless of whether a price is charged (IFRS, 2009). Under this definition, the related party becomes a person or an entity that can control the reporting entity or exercise significant influence in the taking of operational and financial decisions. Some empirical studies define these dealings as transactions between a company and a related person, introducing the concept of qualified insider (Young, 2005, Pan & Hsiu-Cheng, 2007).

From a review of the existing body of academic literature, it emerges that RPTs can be observed from three relevant perspectives. However, all interpretations illustrate the ability of one part to affect the terms and conditions of the dealing.

Some studies give priority to risks over the benefits arisen from the transaction (conflict of interest hypothesis); others emphasize the natural ability of RPT to compress monitoring costs (efficient transaction hypothesis); a more recent part of literature overcomes this dichotomy, offering a new perspective (contingency theory).

By embracing the first approach, the RPT is depicted as a conflict of interests, which may imply a moral hazard and a consequent expropriation of wealth from shareholders. Based on the structure of the entity, RPTs becomes a means of abuse between ownership and control, in a public company, or

a mechanism used by the majority to the detriment to minority shareholders, in a concentrated ownership company (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000). These transactions can produce benefits for the insiders to the detriment of the weaker outsider by diverting resources for their personal use. The lack of legal deterrents to protect minorities can exacerbate this risk (Baek, Kang, & Lee, 2006). Consistently with the previous findings, many studies demonstrate a strong correlation between a weak CG and the number of RPTs (Gordon, Henry, & Palia, 2004; Kohlbeck & Mayhew, 2004). A body of the literature provides evidence of the influence of these transactions on many financial crises (Swartz & Watkins, 2003; McTague, 2004) demonstrating that these could be a useful tool for managing earnings (Jian & Wong, 2008; Aharony, Yuan, & Wang, 2005) to obtain private gain or to achieve a specific aim. The potentially opportunistic use of RPTs is also indirectly shown by data attesting to greater use of RPTs in corporations with weaker corporate governance systems (Gordon et al., 2004). There is a negative correlation in companies with weak monitoring mechanisms between RPTs and their periodic performance (Chen & Chien, 2007). Thus, investors seem to react to RPT announcements and lower current and future share prices for firms engaging in them (Kohlbeck & Mayhew, 2004). Another empirical study (Habib, Muhammadi, & Jiang, 2017) extends the previous literature demonstrating that RPT is a channel through which political connections can be exploited to take advantage of minority investors (tunneling). Following the same view, Kohlbeck and Mayhew (2017) investigate whether RPTs serve as “red flags” that warn of potential financial misstatement. They find that conducting RPTs signals the firm’s insiders are open to self-trading and could be suggestive of the presence of other opportunistic behaviours, such as earnings management.

In contrast with the former perspective, the efficient transaction hypothesis considers RPT as sound business exchanges able to fulfil the economic needs of the firm. This view is consistent with the transaction cost theory (Coase, 1937; Williamson, 1985) and sustained by many other studies. Some authors find a positive relation between RPTs and corporate performance, with a positive impact on the sales and a reduction of transaction costs (Khanna & Palepu, 1997). In some cases, sharing technological skills and advertising, related to available group financial resources, contributes the profitability, supplementing inefficient capital market and decreasing transaction costs (Chang & Hong, 2000; Moscariello, 2012). A more recent study enriches the literature (Roy, Roy, & Kar, 2020) adding that the RPT may represent a mechanism to raise the revenue and profit earnings of the entities.

Finally, the contingency framework, by overcoming or overlapping of the two previous theories, provides a different definition of RPT that can assume different meanings in varying contexts. The RPTs can represent transactions carried out to satisfy sound business needs or to pursue deceptive and fraudulent purposes. Therefore, any a priori theoretical scheme that analyzes the definition and structure of RPTs could always be biased and

may bring about insufficient disclosure or monitoring solutions. The adoption of this third perspective provides the means to interpret RPTs through the lens of contingent factors, arising from organizational contexts (internal factors) or institutional environments (external factors) that could crucially affect the nature and purpose of transactions (Pizzo, 2013). Later, also Marchini, Mazza, and Medioli (2018) extend the corpus of previous studies, testing the contingency hypothesis empirically.

3. LEGAL MECHANISMS AGAINST TUNNELING VIA RPTS

3.1. The Italian institutional setting and RPT discipline

Many corporate scandals shed light only on the risks associated with these transactions, encouraging the suspicious attitude and the common negative perception. Because RPTs are a usual vehicle for tunneling, several jurisdictions provide for specific provisions addressing RPTs as such.

Italy represents an ideal setting to analyse all potential risks of RPTs and the role of regulation to limit them. In particular, the Italian institutional scenario has been depicted as a context with weak managers, strong block-holder, and unprotected minority shareholders (Melis, 2000). Indeed, in a concentrated ownership setting, the presence of a dominant shareholder can monitor senior managers of the company and compress information asymmetry between managers and shareholder (Melis, 2000; Barucci & Falini, 2005), shifting this conflict between majority shareholders and minority shareholders (Volpin, 2002; Mantovani & Moscato, 2020). This principal-principal conflict, also known as Agency Problem II represents the major governance problem of Italian concentrated ownership companies (Dharwadkar, George, & Brandes, 2000; Bebchuk, Kraakman, & Triantis, 2000; Villalonga & Amit, 2006; Young, Peng, Ahlstrom, Bruton, & Jiang, 2008; Renders & Gaeremynck, 2012). The separation between control rights and cash flow rights can generate significant agency problems and costs related to the potential appropriation of private benefits of control by majority shareholders at the expense of minorities (Shleifer & Vishny, 1997; Faccio & Lang, 2002; Federowicz & Aguilera, 2003; Gospel & Pendleton, 2005; Thomsen, Pedersen, & Kvist, 2006). Besides, the weak legal shareholder protection together with the widespread use of control enhancing mechanisms (CEMs) – such as pyramids, shareholders agreements, and dual-class actions – exacerbates the risk of an undue extraction of value to the benefit of controllers. In these circumstances, controlling shareholders could transfer resources from the firm for their benefit carrying out self-dealing RPTs (Johnson et al., 2000), undermining minority shareholders’ protection. This form of tunneling represents a traditional feature and an endemic corporate governance issue in the Italian institutional setting (Belcredi, Bozzi, Ciavarella, & Novembre, 2014). For this reason, the higher risk associated with RPTs has contributed to increasing the need to reinforce protection for non-controlling shareholders. Both research and practice have demonstrated that better

corporate RPT disclosure is required to mitigate the information asymmetry, to compress agency costs, and to guarantee the fairness of RPTs. Therefore, the recent shocking events have also led regulators and standard setters, to strengthen the current rules and principles by introducing new requirements and bans to RPT discipline. The aim of this legislative action is not to prevent the execution of transactions between related parties but only to guarantee their transparent disclosure to the shareholders.

For this reason, the Italian RPT discipline intervened to adopt procedures of fairness as rules to be followed in the decision-making process of the competent bodies (substantive regulation).

Other taken legislative actions have pursued the aim to introduce transparency obligations, i.e., disclosure obligations that the company must fulfil periodically or immediately, to convey all necessary information to the market (transparency regulation).

Many legislative, regulatory, and accounting provisions have been introduced to discipline these transactions.

The IAS 24 (IFRS, 2009) regulating the minimum content of RPTs in financial statement aims to ensure the conveying of all supplementary information necessary to define the impact that these transactions could have on the business management. More specifically, since 2005, under the international principle, Italian listed companies have to guarantee that their financial statements contain the disclosure necessary to monitor the possibility that reported financial position and results could have been affected by the existence of related parties.

For companies that do not adopt IASB accounting standards, the article 2427, co.1, number 22-bis of the Civil Code has established the obligation to describe in the notes to the financial statements only RPTs that are significant and executed under normal market conditions (Quagli, 2018).

Subsequently, since 2010, the Italian regulatory body (CONSOB) issued a comprehensive regulation on listed companies' RPTs, with toughened procedural requirements and heightened disclosure obligations. In particular, the regulation No. 17721 on related party transaction has overhauled the rules on RPTs for Italian listed companies. This new regulatory approach has introduced different procedural requirements and disclosure obligations based on the magnitude of the transaction. In other terms, RPT disclosure varies on the bases of the materiality of transactions defined as the size of operation relative to that of the company.

The regulation on RPT has identified, as the relevant parameter for the identification of material transactions between related parties, the threshold of 5% of at least one or more parameters provided.

This intervention represents an attempt to guarantee the substantial and procedural fairness of related party transactions by improving transparency of disclosure to reduce information asymmetry.

In particular, with the term substantial fairness, the legislator refers to the correctness of the economic operation, which occurs when

the transfer price of an asset aligns with the market price; differently, the procedural fairness indicates compliance with regulated procedural obligations.

More specifically, these obligations intend to promote greater transparency precisely on the transactions, whose nature can incentive a value expropriation, to pursue an opportunistic purpose not aligned with the interest of the company. The primary aim of this legislative intervention is to reinforcing minority shareholders and other stakeholders by counteracting any abuses that may arise from those transactions in the potential conflict of interest. This intervention takes place within the strengthening of the entire Italian corporate governance system of the recent years, aimed to increase transparency in the management of companies and minority shareholders' protection (Rizzato, Busso, Devalle, & Zerbetto, 2018).

More specifically, the regulation for transaction with related parties (CONSOB, 2010) provides two different disciplines:

1. A general procedure regulates RPT below the threshold of materiality. It requires to Related Parties Committee of independent directors to give to the board of directors an opinion that regards the interest of the company into the transaction and the substantial fairness of deals. This opinion is not binding for the board of directors that may equally approve the dealing even if the advice of the Committee is unfavourable.

2. On the other side, a peculiar procedure governs the material RPTs. The transaction approval of the board of directors involves the expression of a reasoned opinion - that is mandatory and binding - from the Related Parties Committee on the completion of the transaction, and the advantage and substantial correctness of its conditions. More specifically, the independent directors have the real veto power on the execution of dealing. In this case, the board of directors can approve the operation only after consulting the RPT Committee composed of only independent directors. More specifically, the whole board can approve material RPTs only when the Committee confirms the fairness of the operation, with its favourable advice. On the other side, in some cases, the expression of unfavourable opinion could, not preclude the approbation and the consequent execution of the transaction. The statute may provide that the board of directors can proceed despite unfavourable opinion, submitting the decision for approval by the meeting of shareholders, (according to the provisions of article 11, paragraph 3). This procedure provides for the so-called whitewash mechanism aimed at preventing the completion of the transaction if the majority of independent voting shareholders votes against the approval. Only if the independent shareholders present at the meeting represent at least a given portion of the share capital with voting rights - not exceeding ten per cent - they may prevent the performance of the transaction. In particular, this mechanism pursued the aim to sterilize the voting rights of the shares held by the majority of interested shareholders, with a consequent balance of decision-making power in favour of minorities. A popular idea in academia as well as among policymakers is that the most effective procedural safeguard against tunneling

is veto power over RPTs for a majority of the shareholders other than the related party itself (a majority of the minority, or MOM, in companies with dominant shareholders) (Enriques, 2014).

As regards informative obligations, when the material transactions are approved, the discipline establishes together with periodic disclosure a piece of immediate information. In this case, an RPT document has to be drawn up under Annex 4 (CONSOB, 2010, 2017) to disclose to the market all relevant information of the transaction.

More specifically, the CONSOB regulation No. 17221 (CONSOB, 2017) establishes that the RPT information document must contain:

1. The indication of the risks associated with potential conflicts of interest deriving from the transaction.

2. The description of the characteristics, methods, terms, and conditions of the deal.

3. The definition of related parties and the economic reasons and convenience of the transaction for the company. When board of directors approve it despite the unfavourable opinion of Committee, the description of motives that lead to this decision is required.

4. The identification of the methods to determine the consideration for the transaction, assessing its consistency with market values of similar operations. Any opinions of independent experts in support of the appropriateness of the remuneration are attached to the information document.

5. The illustration of the economic, financial, and patrimonial effects of the deal, providing evidence of at least the ratios adopted for the significance test.

6. The details of possible variation of the directors' remuneration following the transaction or, in the alternative, a declaration stating that there are not variations.

7. The indication of the financial instruments of the same issuer held by them and their interests in extraordinary transactions, when the related parties involved are the members of the board of directors or control bodies.

8. The specification of the directors or the bodies which have conducted or participated in the negotiations, those who have approved the transaction and their role (independent directors, if any).

9. In the hypothesis in which the relevance derives from the accumulation of several transactions carried out in the same year with the same related party, the Board of directors has to disclose all information for each operation.

Therefore, the ratio of the Italian CONSOB regulation is to ensure that negotiations and transactions that involve related parties are carried out appropriately, following the same procedures of similar transactions executed on the market between unrelated parties.

3.2. The regulatory framework for minority directors: The slate-vote system

In fairness procedure, the assessment of professionals (shareholders or directors) who review the transaction ex-ante and have, in principle,

a strong incentive to approve it only if it is efficient, is an anti-tunneling tool. Supporting this thesis, Paces (2018) recommends a different procedural standard that tries to cope with the issue by empowering non-controlling shareholders. In this new regime, minority directors (non-controlling shareholder-dependent directors - NCS-directors) become a new fundamental player in the boardroom able to carry out a procedural screening of related party transactions (RPTs). In other terms, the introduction of minority directors can be an efficient corporate governance mechanism to enhance the accountability of directors reducing the frictions between block-holders and other investors (Enriques, 2009; Belcredi & Enriques, 2014). In a high ownership concentration context, it compresses the agency problems and costs related to the potential appropriation of private benefits of control by majority shareholders. The appointment of non-controlling shareholders could reinforce the board's independence from the corporate controllers, guaranteeing that at least some of the relevant decisions of the company involve the minorities (De Poli & De Gioia Carabellese, 2017).

Indeed, the empirical evidence collected so far mostly confirms the positive impact of minority directors on corporate governance and financial performance and highlights the importance of minority directors as a mechanism to protect the interest of non-controlling shareholders and increase firm value (Moscariello, Pizzo, Govorun, & Kostyuk, 2018).

The slate-vote system (*Voto di lista*) - an Italian feature of the current corporate governance regulation that (Bianchi et al., 2018) - gives minority shareholders the right to appoint at least one board member. To improve the governance structure of state-owned companies and to make them more attractive to private investors, slate-voting was first introduced in Italy by the Legislative Decree No. 332/94, converted by the Law No. 474/94 (*Legge sulla privatizzazione*) which regulated the privatizing of state-owned enterprises. For the Italian privatized listed companies, this norm required directors to be appointed based on shareholders' proposal of alternative slates of candidates and provided that at least one-fifth of the board members had to be selected from a list presented by one or more minority shareholders. Thanks to the Legislative Decree No. 58/1998, the same procedure of voting became mandatory also for the election of statutory auditors of all listed companies of the Italian Stock Exchange.

After in 2005 (Law No. 262/2005 - *Legge sul Risparmio*), the Italian legislative action encouraged all listed companies to adopt the slate-voting system for the election of statutory directors to prevent possible abuses by the block-holder to the detriment of minority shareholders. In 2007, June 30, the slate-vote system has become mandatory for all listed companies: firms must allow minority shareholders to appoint at least one board member. This action is not compulsory for minority shareholders by recognizing them the freedom to exercise their voting rights by presenting a slate of candidates or not.

4. METHODOLOGY

To clarify the potential use of RPT as a dangerous vehicle of expropriation and the role of minorities in harmful transactions, the following lines will illustrate one of the most recent scandals, which involved two relevant companies operating in the dairy sector.

More in general, we use the single-case study to determine whether the theory's propositions are correct or whether some alternative set of explanations might be more relevant. (Yin, 2014).

This explanatory case study provides evidence of the inherent risks of RPT and the impact of shareholder activism as a tool to limit the effects of the self-dealing transaction. More specifically, it demonstrates that minority shareholders are far from defenceless, and they have, in several instances, become active to influence corporate decisions and/or to avoid expropriation (Bozzi & Belcredi, 2019).

4.1. The controversial intra-group acquisition: The Parmalat Lactalis case study

The French Lactalis group through a public tender offer completed in 2011 has reached 83.3% of the share capital of Parmalat taking control of the whole company. In fact, by the conclusion of this action, the French group Lactalis became the majority shareholder of Parmalat S.p.A. In 2012, Parmalat S.p.A. acquired Lactalis American Group, Lactalis Brazil, and Lactalis Mexico, companies belonging to the Lactalis Group and operating in the American market. This acquisition represented a transaction with related parties because both the acquiring company and acquired were managed and controlled by the same entity, i.e., the parent company of the Lactalis Group (BSA S.A.). The demonstration of the economic and strategic convenience of dealing with the company has entailed the transaction approval.

[..The deal aims to achieve two strategic objectives: to extend the presence of the Parmalat Group in geographical areas where it is not present, such as the USA, Brazil, and Mexico, and to increase the weight in the portfolio of products with higher added value. It will allow Parmalat to enter the most significant international dairy market, the U.S. one. It will take place through LAG, a group that in the last decade has shown a strong capacity to grow revenues and profitability, and has already launched a relevant strategy to accelerate growth. With regards to the increase in the weight of high value-added products, it is worthy to note that LAG Group operates in the profitable segments of soft and fresh cheeses, which are currently substantially absent from the Parmalat product portfolio. It will allow the Parmalat Group to enrich other Group companies, in particular Canada, with significant production, sales and distribution know-how. Parmalat management believes that the dealing will also result in better positioning in Latin America, extending the presence of Parmalat in new markets such as Mexico and Brazil and opening up Venezuela and Colombia markets to LAG products...] (Parmalat S.p.A., 2012, p. 33).

This type of transaction deserves particular attention, as can hide an undue appropriation of the benefit private of control by a majority shareholder.

Adopting the procedure, the transaction approval by Parmalat Board of Directors involved the expression of a *favourable binding opinion*¹ of the independent Internal Control and Corporate Governance Committee, assisted by an expert, which issued its fairness opinion (Mediobanca Banca di Credito Finanziario S.p.A.). The acquisition process has been widely debated, discussing the fairness of the consideration established by the parties, regarding the real value of the companies of the French group. This transaction was able to stimulate shareholder activism and the use of legal tools to protect minority' interests. In these circumstances, a minority shareholder (the Amber Capital L.P. fund) presented a complaint to the Parma Court (Italy), recognizing in the transaction "a debt acquisition aimed at transferring the liquidity of the subsidiary Parmalat S.p.A. to the parent company BSA S.A., with a price higher than the fair amount" (Amber Capital, 2016, p. 10). The acquisition price judged as inappropriate was a central discussion. According to the critical interpretations, the acquisition was a liquidity transfer from Parmalat to funds of Lactalis to reduce - at least partially - its excessive exposure to debt. Under this perspective, Parmalat can be considered part of *cash pooling*² structure of Lactalis Group, i.e., treasury sharing which favouring the transfer of liquidity from the hands of Parmalat S.p.A. into the hands of indebted Lactalis S.p.A. Adjusting the acquisition price, higher than the one defined under normal market conditions, could be seen as instrumental to tunnel resources and extract value in favour of the majority shareholder. After the intervention of a minority shareholder, the price of the transaction - that was deemed inappropriate compared to the value of the companies acquired - became subject to corrective measures, following the administrative proceeding under article 2409 of the Civil Code.

5. THE IMPACT OF THE PRESENCE OF MINORITY DIRECTOR ON RPTS

The quality of the procedures for identifying and approving RPTs (the so-called core indicator) is associated positively with the presence of minority directors in the Board. These findings are also consistent with Bianchi, Ciaravella, Enriques, Novembre, and Signoretti (2014) that argue that the appointment of independent minority directors is associated with stricter related party transactions internal codes. Companies with at least one minority director on the board of directors are more likely to opt for: 1) lower thresholds than those defined by the CONSOB RPTs regulation to identify material transactions between related parties; 2) stricter choices on the *de minimis* amount (whether in

¹ The approval of the transaction by the board of directors has to follow the opinion of the independent Committee (for this reason-defined *binding*). This board expresses a favourable opinion if it assumes that the transaction takes place into favourable terms for the corporation and the party acts in the company's interest (so-called *propping*).

² *Cash pooling* is a valuable treasury tool for practical, day-to-day cash management. Cash pooling allows a multinational group to centralize its internal financing arrangements, providing more control, efficiency, and synergy across the members of the group. There are different types of cash pooling arrangements that can entail some transfer pricing risks.

absolute or in relative terms) below which transaction is qualified as small RPT, with a consequent full opt-out from the RPTs regulation; 3) a lower percentage of non-interested shareholders for the general meeting approval for the independent veto of shareholders to be effective in case of a whitewash procedure; 4) higher budget limits for the fairness opinion independent directors might require for transaction below the materiality threshold; 5) stricter rules concerning possible exemptions from the procedural regime in case of urgency (for example, in case of financial distress) (Cappellieri et al., 2019). Chien and Hsu (2010) demonstrate a positive moderating effect of corporate governance mechanisms on the relationship between related party transactions and firm performance. They argue that corporate governance mechanism transfers these related party transactions from “*conflicts of interest*”³ to “*efficient transactions*”⁴.

Besides, consistently with previous findings, many studies document that directors appointed by minority shareholders are more likely to dissent and that market prices react slightly negatively when a minority-appointed director votes against the majority (Belcredi et al., 2014; Marchetti, Siciliano, & Ventrone, 2017).

According to traditional agency theory, there also exists a strong correlation between corporate governance and disclosure that is crucial for the functioning of an efficient capital market (Healy & Palepu, 2001).

These analyses suggest a certain degree of trust in the market in minority-appointed directors.

Beekes and Brown (2006) assume that companies that present better corporate governance provide more informative disclosures. Indeed, minority directors act as a conduit of information to the market by facilitating further engagement by active shareholders, promoting better communication, and reducing disclosure manipulation.

Indeed, many empirical studies demonstrate the value-destroying related party transactions are shown to the market by significantly less informative disclosure compared to other RPTs.

The controlling shareholders who tunnel assets out of publicly listed firms may be manipulating the information disclosure to conceal expropriation (Cheung, Jing, Lu, Rau, & Stouraitis, 2009).

Indeed, without relevant legal deterrents, RPT communication could be a potential “impression management” vehicle, showing the transaction as a convenient dealing for the company, by emphasizing positive effects (enhancement) or obfuscating negative results (concealment) deriving from the operation. This information could be easily biased mainly to distort the perception of third parties on the risks related to this type of transaction. In detail, it is possible to manipulate this disclosure by ignoring or underplaying the potential risk of the RPT or exaggerating the advantage for the company arisen from the dealing.

Despite the RPT disclosure requirement, the transactions representing *tunneling*⁵ is accompanied by less information disclosure compared to related party transactions representing propping up (Utama & Utama, 2014). In alignment with this approach, Utama and Utama (2012) find that higher-level RPT disclosure is associated with a lower likelihood of abusive RPTs and the relationship between the size of RPT and performance is positive. In contrast, for the firms that present a low-level RPT disclosure, the association is negative.

Djankov, La Porta, Lopez-de-Silanes, & Shleifer (2006) argue that disclosure requirements in annual reports and periodic filings represent a mechanism useful to facilitate the scrutiny of related-party transactions by outside shareholders. They recognize in the extensive disclosure together with approval by disinterested shareholders and private enforcement the most reliable solutions to avoid self-dealing.

Consistently with the previous studies, it emerges that the disclosure requirement is not sufficient to minimize the value expropriation. In general, empowering minority shareholders represents an additional and effective mechanism to reduce harmful transactions.

More specifically, the slate-vote system by improving the quality of corporate governance and enhancing the quality of RPT disclosure enriches the entire discipline that regulates these transactions, thereby reinforcing shareholder protection.

6. CONCLUSION

The RPTs can represent a dangerous vehicle for distracting resources by generating frictions between insiders (managers or controlling shareholders) and (minority) shareholders, with a negative impact on the function of the capital market as a whole.

More specifically, the study adds value identifying several procedural anti-tunneling mechanisms to neutralize this risk: the representation of minorities on the board of directors able to limit the approval of harmful transactions to the company interest (ex-ante screening mechanism); whitewash as an additional tool provided to dissenting minority shareholders to prevent the execution of an expropriative RPT (*in itinere screening mechanism*)⁶; if the board of director approves the transaction, the presence of the minority directors can monitor the quality of information conveyed, improving the transparency of RPT disclosure (ex-post screening mechanism).

In general, the private benefits extraction is not easy to detect, and a comprehensive system of mandatory disclosure and other procedural obligations based on reinforcing of minorities could also be not sufficient to reach this aim. Demonstrating the distraction of resources of the firm for opportunistic purposes is complicated.

³ The *conflict of interest* views portrays related party transactions as potentially harmful to the interest of corporation and shareholders one.

⁴ The *efficient transactions* perspective maintains that related party transactions with good corporate governance mechanisms are helpful to the company's interest and even benefit shareholders.

⁵ The term “*tunneling*” is coined originally to characterize the expropriation of minority and to describe the transfer of assets and profits out of firms for the benefit of those who control them (Johnson et al., 2000).

⁶ We use “*in itinere screening mechanism*” to intend every type of action that takes place during the RPT approval process to prevent the execution of an expropriative transaction.

In the first phase, the intervention of minority directors in procedure reduces the probability to approve an RPT that pursues opportunistic goals, not aligned with the aim of value creation for the company.

In a second stage, when the operations deemed fair are approved, the presence of minority directors enhance information transparency and quality in the drafting of the information document, providing a fair representation of transaction to the market, reducing the risk of impression management.

Despite the contributions, this study is not without limitations. First, this paper examines the minority directors as an anti-tunneling instrument in a single country. Although findings are likely generalizable to other institutional contexts, a cross-country analysis could certainly help to obtain a more comprehensive picture.

Second, the research directs its attention only on the positive impact of the slate-vote system on the risk related to RPTs.

The analysis set the assumption that the slate-vote system is a mechanism to mitigate the risk of self-dealing transactions via RPTs protecting minority shareholders and reducing the risk of undue appropriation of the majority involved in this type of dealings. However, the introduction of this anti-tunneling instrument may generate other and new forms of value extraction.

The minority director represents a praesidium of the only minority shareholders. Even the minority

director is not a priori extraneous to conflicts of interest, as he could - like all directors - become part of another type of opportunistic behaviour. A body of the literature sheds new light on the dark side of shareholder protection and potential drawbacks associated with minority shareholders' representativeness. The presence of these special interest directors in the board could strengthen the risk of potential hold-ups by minority shareholders, threatening the profitability of idiosyncratic investments made by the majority shareholder and favouring an undue appropriation ex-post of the relative quasi-rent (Williamson, 1979; Burkart, Gromb, & Panunzi, 1997).

In conclusion, on the one hand, minority directors can represent an effective corporate governance mechanism to protect non-controlling shareholders from the distortion and extraction of BPC (bad private benefit). On the other hand, they can become a way to expropriate the block-holders of idiosyncratic BPC (good private benefit), limiting the remuneration of entrepreneurial talent and consequently inhibiting the investments of the dominant shareholders.

The deepening of the trade-off between these two different effects could be a suggestion for future research.

The assumptions provided in this study are clearly not conclusive and requires further works to explore an area, which is in its infancy and yet should represent a concern for academics and regulators.

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