

CORPORATE GOVERNANCE AND PERFORMANCE: A STUDY OF THE REFORM OF COOPERATIVE CREDIT SYSTEM IN ITALY

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Abstract

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The aim of the paper is to identify and discuss the suitability of the corporate governance structure of the Cooperative Banking Group (CBG) for preserving the distinctive characteristics of the cooperative credit banks (CCBs), such as mutuality and localism, as well as for guaranteeing the levels of capitalization, respecting the overall performance objectives. The analysis methodology uses a case study. The paper provides some reflections on the possible impacts of a radical change in the Italian cooperative credit system following the 2016 reform. The pilot model needs further adjustments *in itinere*, based on rigorous empirical tests conducted to confer on it the characteristics of universal applicability in the context of the CCBs. The major contribution of the paper is evident from the resulting interpretative process; the analysis conducted on a case study allows us to highlight the importance of the organizational dimension in the CCBs; the performances achieved by these, although with some distinctions throughout the Italian territory, are the result of the adequacy of the governance structures and the corporate control functions, which, even when partly outsourced, are always rigorously inspired by the logic of interconnection among those responsible for the functions themselves.

Keywords: Cooperative Credit Banks, Corporate Governance, Decision-Making Process, Performance

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1. INTRODUCTION

A definition of cooperative credit banks (CCBs) is contained in the sector regulations (articles 35-37 - Legislative Decree 385/93 - Testo Unico Bancario (TUB)), having been established following the issue of the new banking law (TUB) as "descendants" of rural and artisanal credit institutions, preserving, albeit with some necessary adaptation, the economic social function, the juridical form and compliance

with structural and operating "rules", such as the mutualistic purpose, the provision of credit mainly to shareholders in support of the development and promotion of the respective area. These are small or less significant banks, with operations in local domestic markets under the control of Bank of Italy, and connected to the Federcasse, a cooperative credit network. The financial crisis that occurred first in 2007-2008 before and then in 2010-2011, revealed certain weaknesses in cooperative credit,

recognizable in the structural characteristics of this size class of banks, thus making urgent measures to implement capital strengthening policies and solid corporate governance practices.

The first step in the coherent development of the regulator's efforts to define solid corporate governance practices for all banks regardless of the legal form of the establishment can be seen in "The principles for strengthening corporate governance", drawn up by the Basel Committee in October 2010 (BIS, 2010); in February 2013, in order to assess the progress made by the banking sector in the area of risk governance, the Financial Stability Board published the document entitled "Thematic review on risk governance". Moreover, new regulatory requirements were introduced in 2014, which have profoundly changed the "*modus operandi*" of all banks, regardless of the legal form of incorporation. Specific reference is made to the EU Regulation No. 575/2013 (CRR), to the EU Directive No. 36/2013 (CRD IV), which bound the national authorities of the member countries to adopt new measures regarding corporate structure. With specific reference to Italy, Bank of Italy has revised, in general, the regulatory provisions on Corporate Governance and internal controls (Circular No. 263/2006 - New prudential supervisory provisions for banks and Circular No. 285/2013 - Supervisory provisions for banks), and, in particular, for the CCBs, with the Legislative Decree 18/2016, converted into DL 49/2016, introduced a sector regulation aimed at reforming the cooperative credit system, through the establishment of the Cooperative Banking Group to which all the CCBs not opting to sign the "way out" clauses must adhere.

There are many points for reflection on the correspondence of the group governance structure to the achievement of a more suitable capitalization, of adequacy of the internal control system compliant at the principles of safeguarding the peculiarities of "territorial" relations. In accord to Stanley, Doucouliagos, Giles, Heckemeyer, and Johnston (2013), the absence of systematic unbiased or little rigorous analyses are a harbinger of underperforming research results; the theoretical knowledge and empirical evidence available to date on the subject are, in fact, still fragmented, defining an incomplete framework on the topics under discussion.

Studies on the CCBs can be grouped into three main strands on the basis of the research "focus": the relationship between banks and local economies, with specific reference to the "mutualistic" character; the relationship between objectives, performance, and corporate efficiency; governance and relations between the board of directors (BD) and corporate functions for effective risk and performance control.

The research is part of this debate, and examines, in particular, the peculiarities of the current corporate and risk governance structure and on the structural "vulnerabilities" of the CCBs that justify their reform; the aim is to assess the adequacy of the new regulatory requirements to remedy the weaknesses in the governance systems that emerged following the financial crisis and to respond to the business principle of achieving conditions of economic equilibrium in the long period.

The CCBs follow a business model geared to stakeholders; the priority is the satisfaction of the interests of the members, not the achievement of lucrative conditions. Each shareholder can potentially influence the decision-making process, based on the exercise of a single vote. The absence of exclusive profit orientation and the influence of the components of the ownership structure, in the logic of per capita voting has significant implications in the structure and functioning of the governance mechanisms.

Despite the lower levels of profitability due, among other things, to a more conservative business model oriented to traditional intermediation (originate to hold), the CCBs, in the period after the crisis, provided credit to small businesses and the local community, marking an anti-cyclical trend compared to the real economy being well integrated into the local productive networks and in the Italian industrial districts.

For the reason that the CCBs have demonstrated, resilience in the face of financial crises, thanks to the implementation of democratic principles of governance, as well as the adoption of business models inspired by the logic of traditional intermediation, they could be considered valid complementary models to those of the significant banks. The safeguarding of specificities, in a system that tends towards structural change, could provide scholars and regulators with valuable insights for the design of financially stable systems - currently considered one of the main objectives of financial policy at the international and national levels (Financial Stability Forum, 2008; Ayadi, Schmidt, Carbo-Valverde, Arbak, & Rodriguez-Fernandez, 2010; Mottura, 2011; Chiaramonte, Poli, & Oriani, 2013).

However, many situations have led to the need to reform, including:

- 1) the capitalization difficulties, following the necessary and pronounced value adjustments that emerged uniformly for all categories of banks;
- 2) the weaknesses in the governance structure, often disconnected from the logic of "turnover" of the members of the administrative bodies (groupthink risk);
- 3) the rigidity of the cost structure;
- 4) increasingly stringent regulations for the small size (the so-called "one size fits all" approach). The trust placed by the legislator in the large dimension is based on the principles of achieving economies of scale and shared strategies that should strengthen its competitiveness and encourage the hoped-for capitalization process, guaranteeing compliance with the ever-increasing capital requirements required by law.

This article presents a case study as a type of qualitative research since the research is part of a larger project *in fieri*; in fact, we want to investigate the logic of governance and the ability to achieve adequate performance in light of the reforms of the cooperative credit system. Further points for reflection may concern the impact of the system of remuneration on the corporate governance structure and on company performance; comparative analysis of the sector with national listed groups, or internationally with European groups such as *Crédit Agricole*, credit unions in Germany and the Netherlands.

The research questions are, therefore, the following:

RQ1: Can the group governance arrangements be suitable for preserving the peculiar characteristics of the BCC, such as mutuality and localism?

RQ 2: Will the new governance model, although guaranteeing adequate levels of equity, respect the objectives of achieving corporate performance?

On the basis of these premises, the work is structured as follows. Section 2 provides a review of the existing literature with reference to the governance of CCBs and the regulatory framework governing relations between control bodies and functions. Section 3 will describe the methodology used to answer the research questions formulated and, in the last part, the results of the research, and the conclusion will be presented.

2. LITERATURE REVIEW

Formally established by Legislative Decree 385/93 (TUB), the Italian CCBs are considered “descendants” of the rural and artisan banks, of which they preserve, albeit with some adaptations, the economic-social function, the legal form and compliance with structural and operating rules, such as the pursuit of mutualistic aims, orientation towards the development of the area where they operate, exercise of credit mainly in favour of the shareholders (art. 35, co. 1, TUB).

The distinctive features of the CCBs are, therefore, the link with the local area; their character of “mutuality” and of a “non-profit” enterprise, since the credit activity is mainly oriented towards the shareholders and the larger part of the annual profits earned is destined, by statute, to legal reserves and specific funds for the development of cooperation. Moreover, other features concern diffused ownership, as cooperative companies; the variable share capital, conferring powers on the directors to choose new members; the per capita voting system, thus not linked to the number of shares held by each member (Berger & Udell, 2002; Bonaccorsi Di Patti, Eramo, & Gobbi, 2001; Boscia, Carretta, & Schwizer, 2009).

In accordance with the position of Bongini, Di Battista, & Neri (2009), the mission is pursued through the exercise of an efficient management style, inspired by sustainability and competitiveness criteria with the preparation of an offer addressed to the stakeholders. Piersante and Stefani (2012) point out how mutualism and “social economies”, presenting a positive correlation with the establishment of intensive lending relationships, represent the “core value” of the local business. In this sense, Tarantola (2009) states: “the cooperative banks, thanks to the social and solidarity demands inherent in the corporate model, in addition to assisting customer groups potentially at risk of exclusion from the credit markets and, therefore, of usury, have actively supported particular market segments, such as small and medium enterprises” (p. 11).

There are also critical comments by authors who, in order to highlight the limits deriving from the specificity of the CCBs and their relationship lending model, emphasize the importance of the network (Fracassi & Tate, 2012; Finocchiaro, 2007), the only guarantor of the safeguarding of

competitiveness levels in line with those of the “major” banks (Carosio, 2008; Saccomanni, 2007; Capriglione, 2018).

In the last decade, as a result of the occurrence of financial crises, there have been several doctrinal contributions aimed at clarifying the concept of governance, regardless of the size of the bank (Barbagallo, 2016; Cioli & Giannozzi, 2013). The theme has been the fulcrum of lively scientific debates, although the proposals that emerged found a point of convergence in the need for a specific regulation also concerning, among others, aspects of the social responsibility of managers (Schwizer, 2013; Becht, Bolton, & Röell, 2011) attribute the responsibility of achieving overall performance results to the implementation of an effective system of internal controls, the only guarantors of the containment of moral hazard actions and public trust recognition.

Studies on the subject of ownership and control structures have shown over time the characteristics and limits of the CCBs corporate governance system where the implementation of management plans are based on full stakeholder participation; which is to say that the character of co-operative localism conditions are their “*raison d’être*”, given that they have to the roles of institutions that are at the service of the local community with significant elements of mutuality and with multi-dimensional objectives of an economic-social kind (Tarantola, 2008; Carretta, 2012; Locatelli & Schena, 2019). The result is thus the “heterogeneity” of the corporate structure that determines the marked complexity of the governance structures, due to the presence of emerging conflicts of interest between the categories of shareholders (managing members, depositing partners, creditor members, and dependent shareholders) each bearer of opposing interests. The difference in the “shareholder” positions with respect to the relationship with the bank contributes to the definition of different risk propensities expressed by the company base towards the management; thus, the subjects interested in the loan relationships might have a greater propensity to risk than the depositors, independently of the protection guaranteed to the latter by the mechanisms of the guarantee fund. The managing members will have to take into account the heterogeneous nature of the interests that emerge, attributing to each category the relative importance, which will depend on the impact of the same on the probability of re-election (Sacco Ginevri, 2018).

Nonetheless, diffused ownership, typical of public companies, does not constitute an incentive for stock “takeover” processes, hence the control of “ownership” over the activity of managers in order to direct them towards the objectives of maximizing business profit. The stability of the control then appears subordinate to the occurrence of two conditions: the heterogeneous but not polarized composition of the social structure and company profitability.

The board of directors has a central role in the governance structures, for the balancing of the interests of management and shareholders, since this must define, in the interests of the shareholders, the development strategies of the company and exercise direction and control

activities of management. One question arises spontaneously, that is, whether such a situation can always be found even in the CCBs. It should be noted, in this regard, that in the second half of the 1980s, a copious production of scientific research developed on the subject (Hansmann, 2000; Hansmann, 1988), on the composition and dynamics of power in the boards as well as on the relations existing between company performance and rotation in the positions of directors and managerial class. Some studies (Bongini & Ferri, 2008; Panetta, 2005) confirm the greater stability of the members of the board of directors in the CCBs, which could constitute an impediment to the necessary turnover, especially in the presence of negative performances. Although the determinants of this stability are still opaque today, it seems possible to argue that the issue is part of a much broader debate, with reference to the disciplinary mechanism reserved to which top management are subject and the assessment of professional skills, often rather limited. Thus, if, on the one hand, such a problem could be tackled according to a perspective centred on “human capital” and on “knowledge management”, on the other hand, the effectiveness of executive turnover and related organizational procedures could be assessed through the preparation of specific ratios. Some research shows how the turnover in the CCB seems to be influenced by the local dynamics rather than by the results achieved in terms of overall performance (Battistin, Graziano, & Parigi, 2007; Tarantola, 2008).

The latter is an important point in that operational practice has amply demonstrated that inadequate management structures and selection mechanisms can cause highly damaging events for the CCBs (Visco, 2012).

Nonetheless, among these a horizontal II level governance was also developed, which, thanks to forms of consortium collaboration, acts as a guarantor of the peer monitoring mechanism (Piersante & Stefani, 2012), so as to remedy the weaknesses, detected by the stakeholders and emerging in the monitoring activity carried out by the shareholders of the subsidiary. An example in this sense is the *Istituto Nazionale Federcasse*, also with its regional network.

Further developments on the subjects in question have taken place, in years closer to us; specific reference is made to the Principles for strengthening the corporate governance of the Basel Committee aimed at promoting sound governance practices for banking organizations; in February 2013, in order to assess the progress made by national authorities and the banking sector on risk governance issues, the Financial Stability Board published a thematic review. In 2014, the introduction of new and more stringent regulatory requirements changed banking activity coherently. The qualitative and quantitative reinforcement of capital resources pursued by EU Regulation No. 575/2013 (CRR) and the transposition of the EU Directive No. 36/2013 (CRD IV) pushed the Bank of Italy into reviewing the regulatory documents on corporate governance and internal controls.

Thus, from July 1, 2014, the banks had to equip themselves with a new model of governance, redesigning the roles and functions of the internal control system, in compliance with the principle of independence of the corporate bodies.

With regard to CCBs, the model is traditional and defines the responsibilities of the corporate bodies appointed by the shareholders' meeting, as follows:

- the board of directors is responsible for the internal control system and for the definition, approval, and revision of the strategic guidelines and risk management, as well as the general rules for their implementation and supervision;
- the executive committee, designated by the board of directors, plays an “operational” role in the management of the bank;
- the general manager (GM) executes the resolutions of the corporate bodies, which perform supervisory functions, ensuring the correct functioning of the internal procedures.

Management control is exercised by the supervisory body, which collaborates with the audit committee and statutory auditors' members.

The Board of Provirii characterizes the model in the CCBs; it has the functions of control over compliance with statutory, ethical, and deontological rules by shareholders and corporate bodies as well as settling disputes between these and third parties.

Moreover, to comply with the principle of “independence” of corporate functions the CCBs have had to establish new corporate control functions, that is, the internal audit, risk management, compliance, and anti-money laundering function, whose senior managers are involved in defining the corporate strategic document, known as the risk appetite framework, for the assessment, measurement, and management of financial and non-financial risks (Figure 1). Thus, the larger ones monitor all the corporate control functions within the organization, while the minor delegate to an external entity, typically, a local or national federation (Federcasse), some II and/or III level control functions, maintaining however the responsibility for the corporate control function.

In July 2015, the Basel Committee issued new guidelines that oblige significant and less significant banks to adopt an effective risk management function, which under the aegis of a chief risk officer identifies the responsibilities of the different parts of the organization in assessing and managing risks “very quickly”. This company function is outsourced, to regional or national conf-cooperative, on a voluntary basis, by the “smart” (in terms of size) CCBs.

This simplification in the organizational structures brings out even more forcefully those aspects of weakness that characterize these categories of banks: limited professional qualities of corporate officers and overseeing of control functions; governance structures often disconnected from the logic of “turnover” of the members of the administrative bodies – groupthink risk (BIS, 2011); rigidity in the cost structure and increasingly stringent regulations for small size (the so-called “one size fits all” approach); capitalization difficulties due to the necessary and marked adjustments to the value of the balance sheet, an aspect common to all categories of banks that emerged following the financial crisis. Hence the necessary reform of the cooperative credit system; the legislator intervened with the dictates of new rules contained in the Law No. 49 of 8 April 2016, by virtue of which, the CCBs had to opt for membership

of a Cooperative Banking Group or, alternatively, for signing the way-out clause, which, subject to authorization by Bank of Italy, allows their legal transformation into a S.p.A company (Locatelli & Schena, 2019).

The first effect of the reform, the establishment of two groups - Iccrea Banking Group and Cassa Centrale Banca - to which was added the provincial group in the Bolzano area - Raiffeisen Group - which can be classified, from the point of view size, as significant banks, and therefore subject to the supervision of the European Central Bank. The regulator's wish is that larger size will allow the achievement of economies of scale, the implementation of shared group strategies, and more incisive capitalization policies and therefore easier access to the capital market. The Cooperative Banking Groups are constituted as joint-stock companies, with the participating Cooperative Banking Groups having a shareholding of more than 50% and, by virtue of signing the cohesion contract, the latter are bound to the coordination and to the common group management. The holding company has the faculty to exercise the powers assigned to it by the regulations in compliance with the principle of proportionality, monitored by means of vigilant control activities and recourse to early warning system indicators. In exercising the powers conferred by the law, the same issues provisions and monitors their compliance; for this purpose, it has the sanctioning instruments, such as restrictive measures and prohibition of new operations including, in the most problematic cases, the exclusion of CCBs from the group (Ciocca, 2018; Gatti, Giuffrè, & Toncelli, 2017).

In terms of corporate governance, the ways in which CCBs and group leaders are linked, are shared in the cohesion contract (*contratto di coesione*) (Santagata, 2019). The appointment of the corporate and control bodies remains with the shareholders' meeting; however, in the presence of conditions of "professional inefficiency", the parent company is granted powers to revoke and appoint new corporate officers.

Therefore, a process of re-modulation of the autonomy of the shareholders' meeting in the appointment of the members of the corporate bodies is triggered due to the existence of a prospect of patrimonial autonomy supported by the system of group solidarity guarantees. The "adequate" diversification of professional skills is then the guarantor of the highest quality levels of the professional profiles of the bank's administrative and control bodies (Costi, 2019).

The second level control functions and the internal auditing functions are transferred in outsourcing to the holding company, to which, being held responsible for prudential supervision, the approval of each "strategic" operation is delegated. The cohesion contract provides for the joint and several guarantee - cross guarantee - between the parent company and CCBs affiliated, for which the group's liabilities are considered as joint and several obligations. The guarantee instrument is the refinancing actions issued by the CCB in a temporary state of difficulty and signed by the parent company together with the implementation of a shared recovery plan. In these circumstances, by way of derogation from the principle of the per

capita vote, the parent company will have the ownership of a number of votes proportional to the subscribed capital, guarantor of the participatory investment subscribed.

3. METHODOLOGY

The methodology used in this work is the ethnographic case study (Van Maanen, 2006; Yin, 1994; Eisenhardt, 1989). The qualitative approach for collecting information was considered useful in the first step of research aimed at describing and interpreting the logic of governance in the CCBs.

The ECS model, though consistent with single case study investigations, appears promising for the settings of field inquiry (Visconti, 2010). ECS is applied to our research to inquiring the effect of the reform in a BCC.

The combination of the case study and ethnographic gives its intrinsic potential of deeply understanding the dynamics of single organizational contexts by means of qualitative data collection. Moreover, a case study is suitable in theory building at all possible levels, including theory generation, extension, and contestation (Yin, 1994).

The case represents the pilot of the study that is intended to be carried out on a CCB sample aimed at evaluating consistencies (or inconsistencies) and recurring traits that can lead to a general trend towards the logic underlying the decision-making processes of cooperative companies. The case identified was considered useful, functional, and instrumental with respect to the objective that it intends to achieve. The CCB, the subject of the investigation, has maintained over time a marked presence in the territory and has promoted its social and economic development with significant financing operations. The cultural emphasis placed on relations with customers and with the shareholders allows a better understanding of the aspects of innovation with reference to the corporate and risk governance structures and to the relationship between the functions of the internal control system and the corporate performance objectives.

The description of reality has been possible through direct interaction with the representative subject of the CCB and this has made it possible to grasp the point of view on governance issues also in light of the regulatory interventions that have taken place in the banking sphere. This made necessary, first of all, the contextualized knowledge - thick description - by describing the macro system in general and the particular one in which the CCB is operating. Firstly, regulations and directives were collected, taken as general data regarding the number of CCBs and the growth of these realities. The observation concerned, in particular, the various aspects attributable to the mechanisms and rules governing the governance model adopted. The subsequent interaction through a single interview, in accordance with our expectations, made it possible to generate knowledge with respect to specific pre-defined research questions. Clearly, these questions constituted the reference point for structuring the interview but did not strictly define the boundaries of the interaction; this made it possible to understand relevant aspects of the problem investigated that may be overlooked in the

preliminary phase of the research design and which, in general, may prove useful in the second step for the preparation of the questionnaire to be given to a sample of companies in an attempt to generalize the knowledge of the logic underlying the decision-making processes of banks.

Three top managers were interviewed, who were asked to give their opinion on the CCB reform and the process of aggregation in the banking group and how this reform would affect the governance of CCB. The interviews were selected on the basis of their expertise in governance, risk governance, and banking regulation, such as the Chairman of the Board of Directors, the General Manager, and the Chief Risk Office. Semi-structured qualitative interviews were preferred to structured questionnaires due to the expectation of a lower response rate from the latter method. The interviews were conducted mainly by telephone and were recorded with a voice recorder. An interview was conducted in written form and provided by the manager by e-mail. As requested by the respondents, their comments were used anonymously to ensure their privacy.

4. AN ITALIAN CASE STUDY: DISCUSSION

The objective of this section is to present the case study of a CCB established in the central-western Italian region. This region of Italy is representative of specifics of the local bank sector from various aspects, economic development, labour market, financial structure, etc. Being a bank that requires confidentiality in the processing of information, it will be identified as CCB β in the course of the work. It was founded as a rural and artisan bank, following the issue of authorization by Bank of Italy, with prevalent operations aimed at members and objectives to support local agricultural and artisan development; subsequently, it was transformed into a CCB, following the new regulatory provisions, contained in the TUB (art. 35 et seq.); finally, the CCB β was interested in merger-by-incorporation processes as a response to the need for territorial expansion and reinforcement arising from the pressure of competitive stimuli and international regulatory discipline.

The deregulation and liberalization processes that have affected the financial markets over the last twenty years, leading to an intensification of the effects of competition-driven, among others, by the growing need for information technology, have overall drastically impacted the profit margins of banking companies due to the marked rigidity of the cost structure and the slowness in the organizational modernization process; indeed, cooperative credit, maintaining its distinctive characteristics over time, recognizable in the adoption of the "originate-to-hold" business model, consistent with the objective of maximizing stakeholder value, localism, and mutuality, has seen a reduction in the gap between social and economic efficiency.

Stigmatized between primary and secondary legislation and internal provisions, code of conduct, and bylaws, the latter drafted by Federcasse, upon approval of BI, the governance model is the reference standard to which the participating CCB β must adhere. The property has 6,830 shareholders - as of December 2017 - with a marked increase already from 2007, following expansion in size and

area involved, compliant with the strategic lines and addresses dictated by Federcasse. In line with the above, the model adopted outlines the main responsibilities of the corporate bodies in order to guarantee the overall effectiveness and efficiency of the internal control system. Thus, the body in charge of administrative and managerial functions is the board of directors, appointed by the shareholders is composed of the chairman and the vice-president, plus six directors. So composed, the board of directors is responsible for the internal control and risk management system as well as for the definition, approval, and revision of the strategic guidelines and the general rules for their implementation and supervision.

Other corporate bodies are the general management, with the general manager and his deputy. These implement the resolutions of the corporate bodies, which perform supervisory functions, ensuring the correct functioning of the bank and its internal procedures; the supervisory board, composed of 5 members, the chairman, and 4 auditors, of which 2 are deputies, has responsibility for supervising compliance with the laws and the articles of association, respect for the correct management principles, and the functioning of the internal control system and overall organization.

The second and third-level corporate control functions, such as compliance, anti-money laundering, and internal auditing, are outsourced to Federcasse. The risk management function is an exception and is conducted by structures other than those of production, in order to define risk measurement methods. This activity is entrusted to the risk controller, which can also formulate proposals for action to resolve critical areas, highlighting in advance the possible causes impeding the achievement of corporate objectives. Once appointed, after verifying the requisites by the SB, and eventually revoked (with motivation) by the board, having heard the opinion of the supervisory board, the risk controller has the responsibility to support the board in supervising the evolution of the risk appetite of the bank and the risk appetite framework as well as translating risk appetite into a risk limit structure.

The line controls, of a procedural nature, are carried out internally by the structures in charge of operational activities. While it is standard practice for those responsible for managing individual risks to work in close contact with the operating units, the corporate risk management function is sufficiently independent of these and not involved in the process of defining company profitability, in compliance with regulatory provisions. This independence constitutes a *sine qua non* condition for guaranteeing access, by the risk controller, to all the lines of activity and functions that are created potentially to manifest corporate risks, as well as for the subsidiary and associated companies that are exposed to financial risks. Thus, the risk management function has free access to company data and external data.

Even if outsourced, for the other second and third-level corporate functions, the CCB β internally maintains the competence for the control of the important operational functions (IOF) as well as for the management of the risks connected to the outsourcing, by appointing an internal contact person - "IOF contact person", - with adequate professionalism requirements. The IOF contact

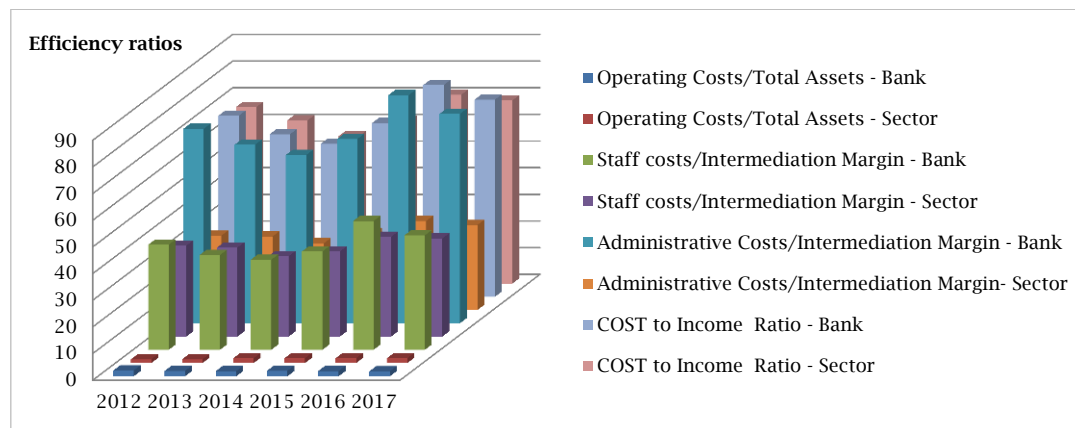
person is responsible for the ongoing monitoring of the activities carried out by the outsourcer, through the preparation of specific communication protocols; the monitoring of the risks associated with the outsourced activities; verification of compliance with agreed service levels; the disclosure to the corporate bodies of the trend status of the outsourced functions; close collaboration with the internal auditing function.

Attention by the supervisory authorities to the self-assessment process of the corporate bodies has raised awareness regarding the internal government of the banks so that each body, according to its particular role, is able, on an ongoing basis, to ensure correct governance of the risks. Assessment of the quality of governance is therefore important because it guarantees conditions of sound and prudent management. Having said this, in the last three years, the CCB β has conducted a process of self-assessment of the governing bodies, in compliance with the

Supervisory Provisions, formalized in an internal regulation (Regulation of the Body Self-Assessment Process), which outlines the methods and tools of the phases of the process, the articulation of the corporate body subject to evaluation and the achievement of the objectives planned by the bank.

The governance structure just described, in fact, has enabled the CCB β to optimize the internal organization and achieve the rationalization of the costs of the structure and of "staff retraining". From a space-time analysis with reference to the post-crisis period (2012-2017), it emerges that the main indicators of operating efficiency have undergone a constant, if not rising, trend, if compared with those of the same sector. The positive results recorded by the bank are the confirmation of governance structures inspired by the logic of promoting corporate culture and responsible ethical behaviour which, as is known, are the only elements guaranteeing the pursuit of adequate corporate performance (Figure 1).

Figure 1. The trend of the post-crisis period efficiency ratios: A comparative analysis of the sector

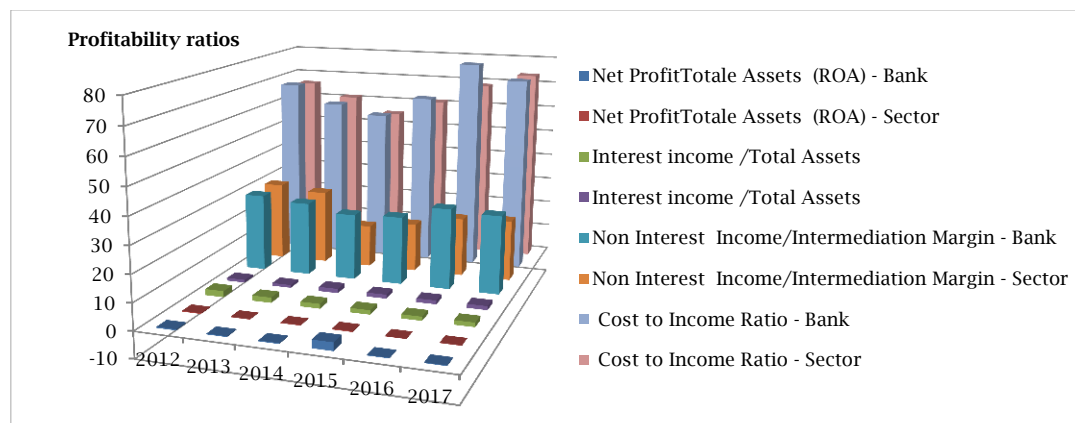


Source: BVLG, data collection (the authors' elaboration).

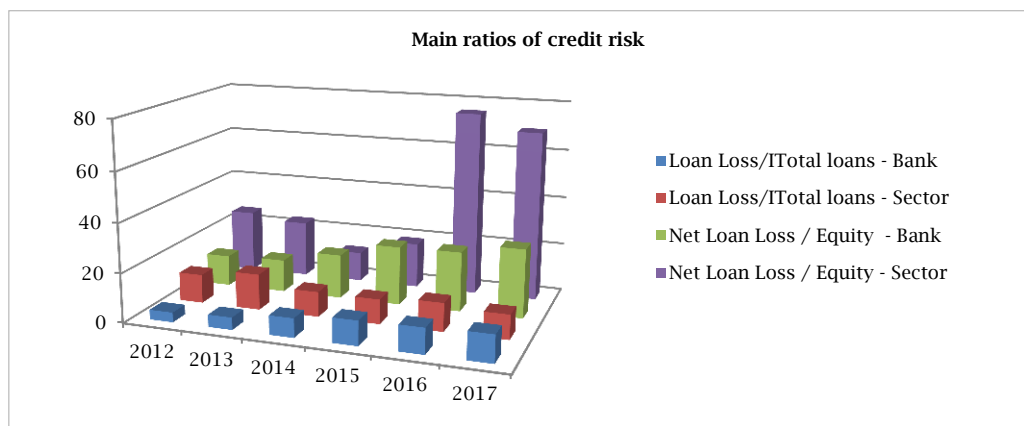
Indeed, from the analysis of the company performance, which is absolutely positive in the values recorded, in a comparison with the system data, emerges the validity of the control and risk management functions. For this analysis, we used

the ratios of profitability, of the riskiness of assets, of the capital requirements and capital levels, for the evaluation of profitability, and of overall performance as shown in Figures 2(a), 2(b), and 2(c).

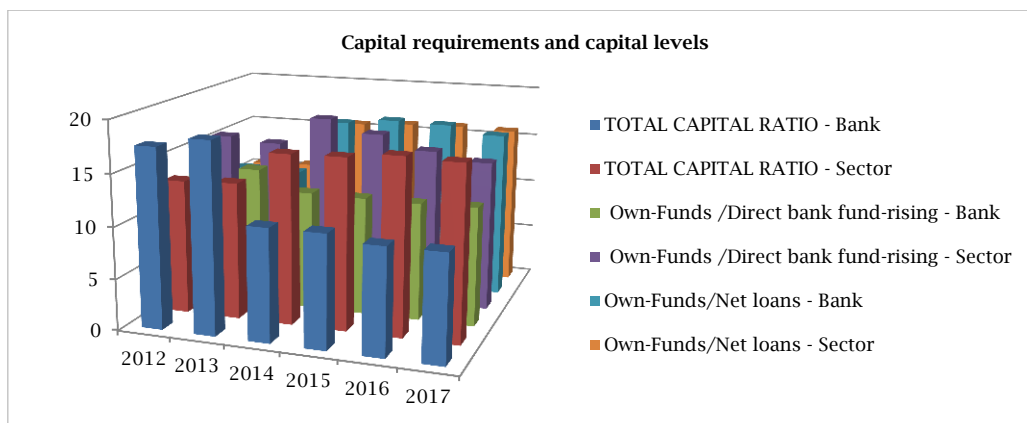
Figure 2(a). Main ratios of overall profitability: A comparative analysis of the sector



Source: Bank of Italy, data collection (the authors' elaboration).

Figure 2(b). Main ratios of credit risk: A comparative analysis of the sector

Source: Bank of Italy, data collection (the authors' elaboration).

Figure 2(c). Mains CCB β ' capital requirements: A comparative analysis of the sector

Source: Bank of Italy, data collection (the authors' elaboration).

The choice of ratios was dictated by the position of the literature on the subject and by the availability of data for analysis. From an evolutionary point of view, the latter confirms the hypothesis of the efficient allocative function carried out by the bank in the reference territory, often in an anti-cyclical manner with respect to the credit crunch that involved banks with an international vocation (Mattei Gentili, 2019). The decrease in the value of the total capital ratio that occurred in 2015 compared to that of the years prior to 31/12 is mainly related to the changes in the fair value of financial assets available for sale recognized in 2015. The persistence of the difficult general economic situation is the cause of the increase in impaired loans, in the face of which significant adjustments were made according to criteria of prudent appreciation of the possibility of recovery. In any case, in the last year, there has been a significant improvement in the quality of the credit disbursed. Risk control is achieved through the regulation of the entire credit process, first and foremost through the careful analysis of the assessment of creditworthiness, the acquisition of guarantees, and constant monitoring of the correct use of the credit lines granted. Hence, the CCB β , in the presence of growth - albeit slight - of the volumes traded, in a period of tendentially zero interest rates, has continued to show reasonable

profitability, considering the impact of prudential provisions and losses on credits on the profits achieved.

For this reason, it can be stated that the CCB β has over time achieved "good" company performance, which is an expression of the valid governance model adopted.

In December 2018, the shareholders' meeting deliberated the adhesion of CCB β to CBG Iccrea S.p.A.; the intention is to exploit the operational and strategic synergies that come from belonging to a group. The bank will continue to maintain the distinctive characteristics of mutualism and localism, operational autonomy, under the aegis of the parent company's corporate control, which will therefore carry out management and control activities with a dual objective: to support the local development function and guarantee stability, solidity, and compliance with the new rules of the Banking Union.

With reference to the governance structures, it is important to stress that the CBG has adopted the traditional governance model; the quality of these structures is measured by the quality of each member of the management structure; therefore, for the consent to adhesion, the CCB β underwent the asset quality review process in order to verify the existence of conditions of solidity and capital adequacy.

The Board of the holding company ICCREA S.p.A. is made up of 15 directors, of whom 9 are Board of Directors' members chosen from the participating CCBs based on the principles of "risk" and the overall structure while the remaining 6 are independent external individuals, among whom, in compliance with the regulatory provisions, the Chief Executive Officer, possessing the requirements of integrity and professionalism, is appointed; at least three of the residual component must have renounced the office held at the CCB, in order to avoid conflicts of interest always considered to be factors that impede the implementation of the principles of "good" governance. The remaining 6 directors, representing the minority in the Board of Directors, will continue to play the role of members of the administrative and control bodies, that is, of top management of the affiliated CCBs. Directors who have renounced the above-mentioned office will be given powers to monitor and evaluate the corporate bodies of the affiliates, while the decision to appoint or revoke them remains exclusively that of the board of directors.

This mechanism for appointing directors, no longer the exclusive competence of the corporate bodies, guarantees the representation of the interests of the CCBs affiliated in the board of directors of the parent company and, constituting an opening of the company to the outside, the lively dialectic among the board's members. The exclusive competence of the corporate bodies to proceed with the appointment of members belonging to the SB also ceases.

From a procedural point of view, the bank's operations are divided into geographical areas, each overseen by local administrators, also called monitoring administrators, who, with the help and collaboration of the parent company's control functions, carry out supervision activities on the corporate bodies of the affiliates. Another possibility would be the establishment of an executive committee made up of local administrators and other independent directors to whom specific powers of control, monitoring, and evaluation of the CCBs would be assigned.

For the CCB β , there will be an internal organizational simplification, partly already achieved with the decentralization of the control functions to Federacasse, which will not affect the network, since the commercial activity is carried out independently. Thus, it will maintain its operational autonomy, having been defined as a "virtuous" bank, according to the parameters of the asset quality review process. As a local bank, it will be able to continue to carry out its activity according to the traditional model of credit intermediation, which, as the graphs above show, is absolutely performing. The credit activity will be subject to compliance with the "policies" defined by the parent company, the autonomy for the classification in the risk classes will be a function of the "virtuousness" demonstrated.

The radical change can be seen in fact in the opening of the social structure to external interventions for capital contribution and for the definition of the centralized control policies on company management. In the first case there is a more rapid capitalization process of the affiliated banks, while in the second case, the mechanism also becomes the guarantor of the containment of

situations of bad management due to incompetence or opportunistic attitudes of the board of directors and the CFO of the participating banks, conferring on the parent company powers to intervene in the presence of risks of bad management. The reform, therefore, determines a shift to the outside of the control, the intensity of which depends on the margin of intervention discretion granted to the parent company: the more direct interventions will be limited to "exceptional" situations, the lower its impact; on the other hand, if the cohesion contract defines this power of intervention in a manner that is more diffuse and less tied to the occurrence of particular circumstances, the shift of the control to the outside will be perceived more markedly. Obviously, since the impact of the reform is commensurate with the extent and operating methods of the powers of intervention granted to the parent company, it will be necessary to take into account the content of the cohesion contract before formulating hypotheses that correspond to the reality of the company.

Finally, with regard to regulatory changes, in particular at the EU level, it would be desirable to simplify new regulations that lead to increased compliance and personnel costs for the CCB or, at most, to lighten the burden of compliance costs. It is also important for the GBC to strengthen and make more effective the mechanisms of mutual support and localism, which are the hallmarks of CCBs. On the contrary, the question remains open as to whether the bail-in could be an excessively costly tool for these banks in the event of unforeseen risks or potential bank failures (the bail-in system which came into force on January 1, 2016, for other banks) or whether it would be more appropriate to use the resolution schemes already provided for by the cooperative credit network. Any regulation should take into account, as far as possible, both expected and unforeseen consequences. In particular, the risks of CCB being forced to limit its ability to support local communities and economic operators should be minimised, which could lead to further credit rationing, a lower supply of credit to local businesses, and a reduction of obstacles to new business activities.

5. CONCLUSION

The research is an empirical study on the distinctive features of the corporate governance structure of a cooperative credit bank which, as per recent regulatory provisions, in December 2108 signed a participation agreement with the GBC ICCREA S.p.A. The systematization of the scientific literature, which aided the development of both research hypotheses and empirical analysis, was followed by the discussion of a case study demonstrating how the legal form of the CCBs is binding for corporate governance mechanisms, since internal regulations and external rules, typically regulatory, assign specific roles and responsibilities to the corporate control functions involved in the governance process and also condition their ownership structure.

Once the existence of a specific governance model was demonstrated, the use of the CCB literature and the case study, allowed us to assert that the CCB β presents an absolutely valid

governance model that respects the principles of prudential supervision. The analysis carried out shows how the results achieved by the CCB β , in the last five years are able to achieve value creation objectives according to a stakeholder approach.

However, from the examination of the literature and of the empirical contributions, a single judgment does not emerge with respect to the validity of the governance model adopted by the CCB; it seems, in fact, that conflicts of interest and distortions in remuneration policies overlap with diffused share ownership; limited/poor professional qualities of corporate officers and overseeing control functions; governance structures often disconnected from the logic of “turnover” of the members of the administrative bodies (risk of groupthink); capitalization difficulties; these elements hinder the identification of the relationship that corporate governance assumes in relation to allocative and operational efficiency.

This dystonia was the starting point of our empirical analysis; in the light of the reform of the cooperative credit sector, which is also aimed at removing the weaknesses in the governance models of the CCBs, even if with some distinctions between those operating on Italian territory, we want to investigate the correspondence of this reform to the specific operational characteristics, if suitable for the definition of governance structures aimed at promoting corporate culture and responsible ethical behavior.

The analysis conducted on a single CCB made it possible to highlight the importance of the organizational dimension; the performances achieved, which were fairly good, are the result of the suitability of the governance structures, pursued with the redesign of the governance processes of the corporate control functions, which, although partly outsourced, are inspired by the logic of connection among the managers. Strictly paced reporting flows, the procedures for appointing corporate officers, and the structure of corporate governance structures were guarantors of the pursuit of shared strategic objectives.

Hence, the necessary twofold traceability to the role of the GBC holding company, with responsibilities on the coherence of the overall group strategic direction and on compliance with the specific provisions issued by the competent sector authorities, concerning the methods of articulating relations with the CCBs.

The definition of several group aggregates gives rise to a change not only in the morphological configuration of the CCBs but also in the operational profiles and governance structures that have so far characterized their essence.

In belonging to the Cooperative Banking Group, distinctive features of the adherents will be respected to the extent of the riskiness manifested by each of them; “invasive” interventions on the part of the parent company will be justified when necessary to bring progressively debacle situations back into equilibrium. Hence, the answer to the *RQ1*, that is, whether the group governance structures will

be adequate for preserving the distinctive features of the CCBs, such as mutuality and localism.

As regards, therefore, *RQ2*, if the adequacy and compliance of the corporate governance model are reflected in the capitalization of these banks, we can affirm that a correct assessment, measurement, and management of risks is the consequence of solid corporate governance.

As is known, the judgment of the “quality” of the corporate governance structures derives from the analysis of the results from the product management; the survey of overall performance (Figures 2(a), 2(b), 2(c)) leads us to argue that the model adopted by it complies with group requirements and is able to guarantee adequate levels of competitiveness.

The work constitutes research “in progress” and is part of a larger project on the evolutionary aspects of the group’s corporate governance structures; the aim was to create a solid theoretical background for future studies.

The impact of the remuneration system on the corporate governance structure and company performance, on the one hand, and a comparative analysis of the sector with national listed groups, or internationally with European groups such as *Crédit Agricole*, *Credit Unions* in Germany and the Netherlands, on the other, may be cause for future reflections.

On the other hand, the governance models presented in the empirical and doctrinal contributions highlight dystonia regarding their ability to pursue long-term economic equilibrium conditions; this dystonia was the starting point of our empirical analysis: in the light of the reform of the sector, which aims to remove the weaknesses that have emerged there, we wanted to shed light on the capacity of the new group corporate governance structures to promote corporate culture and responsible ethical behaviour, as noted, the only guarantors of the pursuit of adequate corporate performance.

What are the limits of the study? Like all governance systems that deal with transformation enterprises based on processes, this must be able to manage any change deriving from the evolution of the sector. To this can also be added, it’s no necessary characteristic of the universality of application, dependent, as is well known, on the no comparability of the governance system which to date are, however, still not very homogeneous. This article presents a case study as a type of qualitative research since the study is a part of a larger project *in fieri*; we have investigated the logic of governance and the ability to achieve adequate performance in light of the reforms of the cooperative credit system. Further points for reflection may concern the impact of the system of remuneration on the corporate governance structure and company performance; comparative analysis of the sector with national listed groups, or internationally with European groups such as *Crédit Agricole*, *Credit Unions* in Germany and the Netherlands.

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