COPENHAGEN BUSINESS SCHOOL

Cand.merc FINANCE AND STRATEGIC MANAGEMENT

MASTER THESIS

ON CORPORATE GOVERNANCE:

OWNERSHIP CONCENTRATION AND FIRM PERFORMANCE IN ITALY

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RESUME'

The objective of the work is to provide deeper explanations of the implications of a specific agency problem involved in the relationship between majority and minority shareholder within a firm, applying this thematic to the Italian capitalist system.

In order to achieve this aim the work is structured into three parts.

The first part aims to analyze the corporate governance topic in general terms. Specifically, after a brief introduction on the agency problems, the agency theory, the origins and the main characteristics of corporate governance, the approach conclusively focuses on the differences among the different countries in the world approaching the topic of corporate governance.

The second part entirely analyzes the Italian Capitalist structure under a corporate governance point of view. After exposing the historical sketches bringing the Italian system to the actual scenario, a deeper analysis on the specific agency issues deriving from companies characterized by a concentrated ownership. In conclusion of this part of the work a description of the Italian board structure and the main corporate governance reforms enforced during the recent years is provided.

The conclusive part of the dissertation relies on the statistical analysis of non-financial companies listed on the Milan Stock Exchange. In specific, after obtaining the data needed for the regressions from a database specialized on storing ownership and financial data of the companies (*Bureau Van Dijk "Orbis"*), selected variables, which are considered to be relevant for the study from the observation of major authors' works, have been regressed against other selected variables aiming to highlight the profitability of the firm and its value.

After implementing these regressions the obtained results are commented, criticized and compared to the theories explained during the exposition of the work.

The last part of the work comprehends the final remarks and the personal suggestions for the implementation of further researches.

Questo Lavoro è dedicato ai miei amatissimi nonni

Gioconda & Sergio.

Vi porterò sempre nel mio cuore.

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CHAPTER 1: INTRODUCTION

1.1 Motivation for the choice of the subject

The relevancy of the corporate governance measures and the growth of the attention towards this field caught my attention for several reasons.
Firstly I thought that a deeper exploration in this field would have provided me a strong added value in order to understand the ongoing corporate dynamics, which are pushing the companies to improve their transparency under their governance point of view. In fact the study field of corporate governance has been characterized by a rapid expansion of its literature and study during the recent years, catching the attention of important researchers which are now focusing on the corporate governance dynamics in order to explain firms' outcomes and also performance.
The huge financial scandals affecting the economy during the last decade (Enron, Worldcom, Parmalat, etc.) put a further and stronger emphasis on the importance of understanding how and by whom firms should be governed. Thus my interest was to understand which are the rules that should be enforced not only in a single firm, but also in the entire economic world in order to prevent these scandals to happen again. My interest was hence to understand how these rules could avoid the occurrence of other major financial scandals and improve the value of the firm not be enhancing the productivity, but by providing a more clear vision of the insight of the company itself, ensuring a more loyal and clear relationship with all the investors.

After making these considerations my attention was caught the three major agency problems, identified as the governance issues affecting the firm that corporate governance aims to solve. In specific the agency problem occurring between majority and minority shareholders strongly interested me. In particular my considerations focused on the hypothesis stating that the company value has a positive correlation with the ownership concentration until a certain point. After reaching that point a further increase in the ownership concentration will start negatively affect the value of the company (Thomsen (2008)).

In order to test this hypothesis I needed a "sample" allowing me to have a deeper insight on the problem. I thought that in order to test this dynamic I had to choose a country where the

model of ownership concentration was easy to observe. The choice thus fell on a Continental Europe country, in specific Italy, since it is commonly known by having a very high degree of ownership concentration. Thus my main interest became the analysis of the Italian market in order to understand which were and are its ongoing corporate dynamics. The theoretical comparison with other economies showed how and why Italian capitalistic system was considered as obsolete and needing a renewal. The choice of the Italian market relied on the deeper personal knowledge and the evident ownership concentration characterizing the Italian capitalistic system also provided a great example for my studies. Furthermore I always wanted to understand how the Italian governance system ended in relying on such a corporate governance system. This thus provided a strong incentive for me to focus more on the corporate governance issues affecting this country.

In conclusion, it was also very important for me the fact that this type of research would have allowed me to provide my personal contribution to the field. This is possible through a first person analysis on the industrial listed companies of the country. The possibility of working in first person on the available data of the companies and construct my personal model from which I could draw my personal conclusion have been without any doubt a powerful motivation pushing me to accept this choice of working on corporate governance issues in the Italian market.

1.2 Problem Statement

The main questions this works aims to answer are to provide a discussion on corporate governance. In specific it will be analyzed if there is a relationship within the ownership structure of a firm and its performance and firm value.
Hence the main question to be answered will be:

-Do the agency problems involved in the ownership concentration affect the value of Italian industrial firms?

The above described question will be solved by answering to several sub-question which have been the main guidelines for the development of my work:

In the first part the main question can be summarized with these two main questions:

-What is corporate governance?

-Do differences exist in corporate governance approach in different countries of the World?

In the second part of the work the leading questions have been:

***-**How did corporate governance system developed in Italy?*

-What are the main agency problems affecting a family/pyramidal groups?

In the third and last part the implementation of several regression will try to answer to these questions:

-What is the effect on the value of the firm and its profitability of a concentrated ownership?

-Does a more powerful minority shareholder help to mitigate the agency problems deriving from a concentrated ownership?

-Is the value of the firm and its profitability affected by the nature of the largest shareholder?

-Are the results in line with the theoretical issues highlighted in the literature review?

1.3 Delimitation

Since corporate governance is a huge area, which cannot be covered in only one work, a specific area had to be selected for a deeper analysis. The purpose of this work is thus to focus on the impact of specific agency problems on the company.
Hence the first part of the work will deliberately avoid deeper discussions on some corporate governance aspects as for example mechanisms and agency theory. Meanwhile it will be put more effort and in order to provide deeper discussions on some topics as for example the legal differences characterizing corporate governance in different countries of the world.

Further on in the text the discussion will become narrower, focusing almost solely on Italian capitalistic system emphasizing the more relevant corporate governance thematic of specific agency problems, which may arise in an economy with the characteristics of the Italian one.

The last part of the work will be a statistical analysis conducted on the data of Italian listed companies. Although the best way to analyze the corporate governance effects on the firm would be to highlight the pyramidal structure of the different groups (thus highlighting the specific network, linking all the different parts of the chain) this was made impossible because of the high level of complexity of the pyramidal structure, which in some cases could include also hundreds of different companies. In fact the only way of "climbing" the steps of the ladder to reach its apex would be to manually compute the entire system by extracting ownership data from the Italian Security Exchange Commission (CONSOB) database. However this process would have been to slow and consequently the risk of not finishing the work by the specified deadline had to be bore. Hence the material lack of time prevented the creation of the entire pyramid structure of all the considered groups. Furthermore, since not all the companies of the group might be listed, there was also the chance to arrive to a dead end. Meaning that the necessary ownership information to complete the ladder to reach the top could be un-available, thus leading the entire reconstruction to a dead end. This issue of complexity and data availability is also pointed out in other research as the La Porta (1999).
In conclusion he regression will not take into account the effects of the nature of the first and third shareholder type on the value of the company.

1.4 Methodology

The methodology adopted in this paper mainly relies on two different approaches: inductive and deductive. The two different approaches have been mainly used in relation to the part of the work and the expected contribution they had to provide.

The deductive approach is implemented when a certain problem or mechanisms have to be explained by fixing a starting point or a certain statement. On the other side the inductive method relies on empirical observations and results to obtain a generalized conclusion. Hence it uses a sample of observations, which are applied to provide broader statements about the subject of the analysis. The main source of the inductive methodology is statistical analysis, which is subsequently used to provide mathematical proof of previous statements deriving form the deductive analysis of the problem.

In this work both of the two methodologies are used. In the first two parts of the work, regarding the theoretical analysis of corporate governance, agency problems and the differences of corporate governance model in different countries, the deductive methodology was broadly used in order to provide the theoretical fundaments for the subsequent analysis.

Consequently the inductive analysis was mainly adopted in the last part of the work, where a statistical analysis has been conducted on a five years sample of Italian industrial listed companies. The aim of the inductive method is hence to provide a generalized conclusion comparing the finding of the previous deductive analysis trough the implementation of statistical regressions. The main aim of the inductive methodology was to discover and analyze if and how a capitalist system characterized by a high degree of ownership concentration affects the overall value of the firm and/or its profitability.

Although the reliability of the analysis can be considered as relatively high due to the great number of observations obtained during a period of time of five years, the model may have suffered from some possible drawbacks.

Firstly the main source of data the *Bureau Van Dijk "Orbis"* database suffered from some structural problems and internal mistakes, which could relatively affect the model (as missing data or wrong data insertion), however due to the great number of obtained observations the missing or wrong fields are considered as non-influential issues. Secondly the impossibility of re-creating the pyramidal structure trough the use of the database placed a limit for the analysis. Thirdly the misspecification of the model could have led to a low significance of some selected parameters. In conclusion the limited knowledge of advanced econometrics techniques could also have influenced the final outcome of the regressions.

1.5 Critique of sources

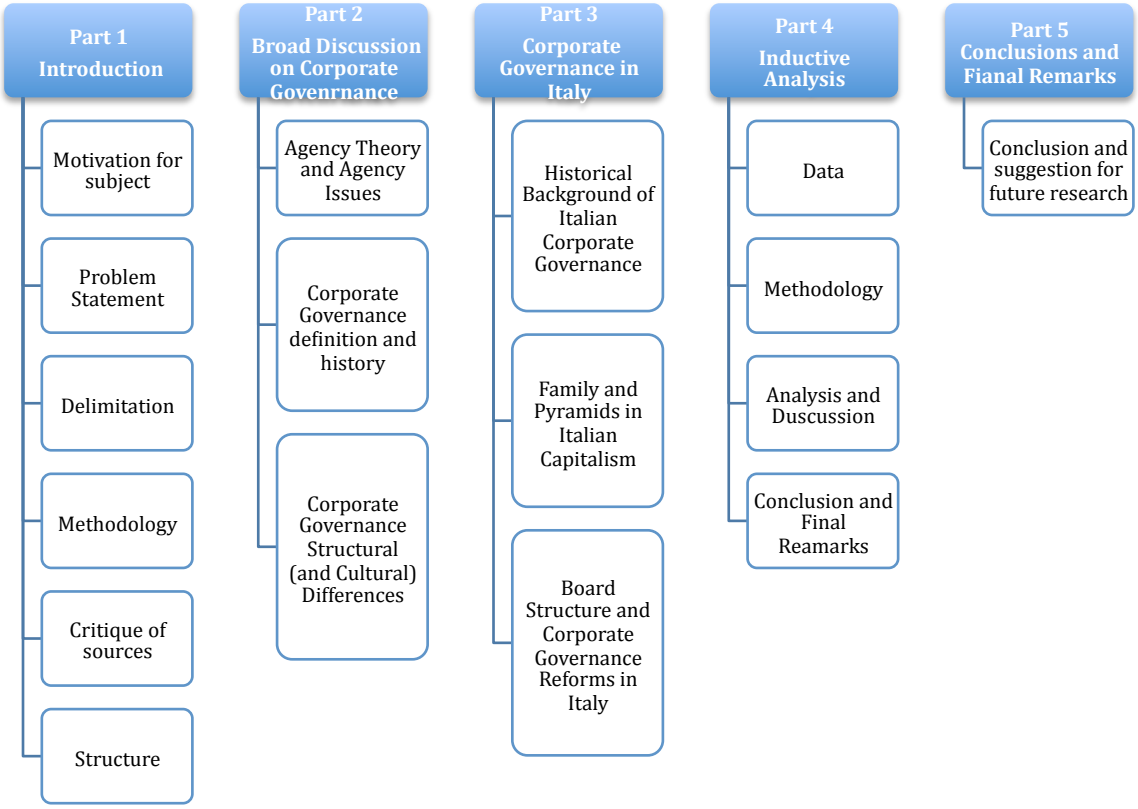
In order to provide a strong backbone for the structure of the work several reliable sources have been consulted. The main purpose of these sources has been to provide the theoretical path and fundaments for the correct development of the work, by being the primary source of information for the argumentations of the different sections.
In the first part of the work the main source has been the papers analyzing corporate governance in general terms, thus focusing the discussion of the origins of corporate governance and the analysis of the agency problem. In specific the primary source for the first part of the work has been papers related to the explanation of agency problems and their origin, corporate governance mechanisms and their applications and in conclusion, the research focused on works providing the theoretical bases for the analysis on the differences of corporate governance aims in various countries (as for example the distinction between *shareholder* and *stakeholder* supremacy) also from a legal point of view.

In the second part of the work the focus of the discussion has narrowed towards the specific case of the Italian market. Thus the main objective of the sources of this chapter has been to provide a deep insight of the Italian capitalism to extract the relevant topics for the discussion.
The first part of this chapter primarily focused on the history of the corporate governance in Italy. Hence the main sources have been several works discussing the subject in deep. The main issue encountered during this phase regarded the fact that most of these sources has been written at latest by the beginning of the 2000. Hence the excluded from their dissertation the most relevant fact affecting corporate governance reforms during the last years (as for example the financial scandal, and especially the Parmalat one, leading to the creation of a new set of rules and suggestion that had to be adopted by the companies).
In the second stage of this chapter the sources mainly had to provide a theoretical explanation of the structure of the Italian capitalist system. In particular the topics of the sources were mainly related to the explanation of the concepts of pyramidal groups and family business, focusing on the reasons of their creation, their possible benefits or drawbacks and evidences justifying the hypothesis of ownership concentration and family business in the actual Italian market.
In the last part of the chapter the main aim has been to find reliable sources on order to clearly explain the Italian board system (which differs under some points of view from the one tier

and two tiers) and the corporate governance reforms recently implemented in Italy in order to enhance the transparency of the Italian governance system.

The last part of the work mainly saw the adoption of statistical and econometric text useful to successfully implement the statistical regressions. Thus the main aim during the source research for this chapter was to find some reliable sources allowing me to understand the theoretical mechanisms that had to be implemented in order to provide accurate statistical regression, which should confirm or deny findings of the other sections of the work.

1.6 Structure



Part 1 "Introduction": The first part provides an introduction to the work highlighting the purpose of the work, the motivations, the limitations of the work and the structure adopted in the development of the selected subject.

Part 2 "Broad discussion on corporate governance": This chapter is a uses a theoretical approach analyzing the most relevant corporate governance elements. This part aims to provide a broad discussion on the subject, which are the backbone of the entire structure of the work.

*Part 3 "Corporate Governance in Italy":*In this part the discussion will become more narrowed highlighting the key points of the corporate governance in the Italian market. In specific the history and the corporate structure (and its related problems) will be deeply analyzed under a theoretical approach.

Part 4 "Inductive Analysis": The analysis will become inductive by implementing different regressions aiming to highlight how and if the ownership structure of the industrial listed Italian companies affects the value of the firms and/or their profitability.

Part 5 "Conclusion and Final Remarks": This is the conclusive part of the work where it will be analyzed the results of the statistical regressions and suggestions will be provided on possible topics for future research highlighted by the results of the statistical regressions.

CHAPTER 2. WHAT IS CORPORATE GOVERNANCE? (A BRIEF DISCUSSION)

During the last two decades the attention toward the study field of *Corporate Governance* slightly increased. Several factors drove the attention of the researchers to focus more on government of the companies. Some huge financial scandals, like Enron in the US or Parmalat in Italy, or alternatively the privatization wave of the eighties, highlighted the importance of providing a deeper study on how the firms should be governed and which mechanisms should be implemented in order to ensure a wise conduction of the companies.
Although its relevancy and the great number of works produced until now, it has been impossible to provide a unique and commonly accepted definition of Corporate Governance. Cultural differences and the diversion of agreements regarding the ultimate subject having right on the returns from the company, continued to undermine the possibility to reach a sole characterization of "corporate governance". In specific, for the Anglo-Saxon model, which is mainly adopted in countries like in the US and UK, a firm should maximise value in favour of its *shareholders*. Alternatively in other countries like Germany, France and Japan a firm should not only create value for its own shareholders, but it should also take into consideration the population of the other *stakeholders* described as all the other subjects who are related to the firm by any possible relationship (like customers, employees, suppliers, etc.).

Even if until now it was not possible to provide an exclusive description of corporate governance, it is clearly possible to highlight where all the efforts are concentrated. The final objective of corporate governance is thus to highlight and consequently mitigate the *Agency Problem*, described as the problem occurring when an agent act differently from its principal's will.

2.1 The Agency Theory and the Agency Problems

2.1.1 *The Origins of the Agency Theory*

An important initial contribution to the study of *Agency theory* is based on the intuitions of Berle and Means (1932). In their work they highlighted that in large companies usually there is a separation between ownership (represented by the investors and shareholders) and

control, held by the management of the company. They also questioned whether this scenario had consequences under the organizational and public policy aspects.

The reason of the agency theory's existence relies on the fact that owners (*shareholders*) have the financial availability but they do not have the capabilities to manage a company, thus they have to rely on some professional executives behaving in their interest. In this scenario owners and executives preferences and goals may collide creating what in literature is called an "*Agency Problem*".

An agency problem arises when the goals and division of labour of cooperating parties are different (Jensen & Meckling (1976)). In specific agency theory analyzes the relationship where one party, called the *principal,* delegates work to a second party named the *agent*, who has to perform it. In the case of a company, the "role" of the principal is obviously covered by the shareholders of the firm; meanwhile executives are the agent who has to perform on shareholder's behalf.

So the aim of agency theory is to evaluate the two main agency problems arising when the objectives and the will of the principal collide or diverts with the one of the agent. In other terms the risk aversion may lead the two parties to go against each other.

2.1.2. The Firm as a Nexus of Contracts

Starting from the definition firm as a nexus of contracts (Jensen & Meckilng (1976) Coase (1937)) where *"Contractual relations are the essence of the firm, not only with employees but with suppliers, customers, creditors, etc"*[1], agency theory developed two different braches with the relation between a principal and an agent as the unit of analysis: the positivist stream and the principal agent.

The *positivist stream* researchers focuses more on identifying possible scenarios leading to a conflict between the principal and the agent and subsequently trying to provide the corporate governance mechanisms to mitigate the agency problem. The main contribution and focus of the positivist researchers is thus to deeply analyze the contractual relationship between the CEO of the company and the shareholders (Eisenhardt (1989)). Their main arguments are that

[1] Jensen M, Meckling W. 1976 "Theory of the Firm: Managerial Behaviour, Agency Cost and Ownership Structure" *Journal of Financial Economics 3,* pp 310

the agency problem between a principal and an agent can be solved through the implementation of an optimal contract, which in order to be really considered optimal and effective had to be outcome based in order to make the agent behave in the interest of the shareholders (principal). The second argument relies on the reduction of asymmetric information. In theory when the principal has the enough information to effectively control its agent, this one will act fulfilling the interest of the principal.

Meanwhile the *principal-agent* branch is more focused on analyzing the principal-agent theory under a broader point of view. They are more concerned about providing a more general theoretical approach, applicable to a wider range of contractual relationship, as for example employer-employee or buyer-supplier (Eisenhardt (1989)). Thus they primarily differ from the positivists on the range of considered relationship: while positivists mainly focus on the shareholders/CEO relationship, principal-agent researchers try to consider a wider variety of connections.
Furthermore principal-agent researchers rely more on a more abstract and mathematical approach for their research counting on hypothesis testing.

Given their nature positivist stream and principal-agent stream do not have to be considered as opposite approaches but, on the contrary, they are two complementary theories, which, if wisely combined, may provide a deeper insight of the agency problem. While positivist evaluate contract alternatives related to the scenario, principal-agent theory provides the most efficient contractual solution given the levels of risk aversion, outcome uncertainty and available information.

2.1.3 Types of Agency Problems

Until now it was discussed in general terms what agency theory is and its main assumptions, however in the real world the principal agent theory can be applied to several categories of relationships within the firm's boundaries. Thus the agency problem affecting a firm cannot reasonably be considered only in a two parties (principal and agent) relationship but it has to be extended to all the parties having connections with the company.
There are mainly three types of agency problems affecting the interaction and interests of subjects related to the company:

1. *Agency problem type 1: owner-manager problem*

2. *Agency problem type 2: majority and minority investors*
3. *Agency problem type 3: shareholders and stakeholders*

Agency Problem 1: Owner-manager problem

The owner-manager problem relies on the first observation of Berle & Means (1932). In fact this agency problem arises only when the ownership of the firm is separated from the management. Thus without this separation this problems should not arise because in case of an owned-managed company both the ownership and control are in the hands of a unique subject.

In case of a misalignment of interest and goals management may act in ways that are in the managers' own interest but against the interest of the owners. For example undertaking "self dealing" (i.e. use company's money for transactions which they benefit in the end), "overinvestment" (i.e. an investment not required because it would have been cheaper to buy from another source), "empire building" (i.e. the temptation that manager have to run a bigger company because it is more prestigious and payment are higher since related to the company size), "excess expenditure"(i.e. undertake expenses which are not made for the benefit for the company but for private benefits) and "entrenchment" (i.e. the construction of barriers helping manager to assume a position where they are difficult to be fired or removed).

Agency problem 2: majority and minority investors

A major shareholder may act in several ways that he/she will obtain substantial benefits exploiting his advantage position (brought by owning the majority of the shares). Although leading to possible benefits for the majority shareholder, it might be the case that these actions may affect the minority shareholders by behaving against their will and thus reducing their wealth.

The assumption of this problem might rise whenever a consistent group of shares is held in the hands of a unique entity, which has different interests compared to the rest of the minority shareholders population. Through the higher decisional power given by the majority of shares the "blockholder(s)" may lead to an entrenchment situation, ending in undertaking actions aiming to expropriate wealth from the rest of the minority shareholders (Fama & Jensen (1983)). Given the characteristics of this agency problem its appearance is more probable in the countries where traditionally the ownership is more concentrated in the hands of few large shareholder or founding families. Several studies showed that this problem usually arises

when the minority shareholder protection laws are undefined or difficult to enforce in court (Demsetz & Lehn (1985)).

Examples of this specific agency problem are for example: *Self-dealing, Creative self-destruction* and *tunneling*. In all of these practices the major shareholder obtain benefits from his/her advantage position but affecting the wealth of the minority investors.

Agency Problem 3: shareholder and stakeholders

In order to pursue their personal interests shareholders may undertake decisions affecting and reducing the wealth of the remaining stakeholder population. An example is the closure of a production plant in an area where unlikely the employees will be able to find another employment, or alternatively the decision to implement very risky strategies diverting from the interest of the creditors.

2.1.4 Agency Problem Characteristics

There are some theoretical reasons relying at the base of the agency problem. In fact without the presence of this factors affecting the relationship between the principal and the agent, the agency problem would not exist because it would be solved at its beginning.

The first factor (and maybe the most important) is *asymmetric information*. Asymmetric information is the advantage of one party brought by the possession of more information than the counterpart. Contextualized in the agency theory asymmetric information highlights two risks bore by the principal: *adverse selection* and *moral hazard.*

- *Adverse selection* is a risk bore by the principal ex-ante the moment of the decision due to information known by the agent but not by the principal. This problem for example may arise whenever a new executive has to be hired and she hides some information resulting relevant for the decision.
- *Moral hazard* is on the other side the risk bore by the principal ex-post the moment of the decision because of the impossibility of constantly monitoring the activity of the agent. The solution of this problem is thus to enforce better capability of monitoring the actions of the agent. As for example a board can have some extra-meetings in order to check that the management is acting wisely and not committing frauds or mistakes.

Moreover other important factors may lead to a conflict between a principal and an agent: divergence in interests brought by the selfishness, uncertainty (i.e. the risk brought by external elements leading to difficult evaluation of the agent activities and related performance), different rationality and different risk aversion (for example a very risk adverse agent may demand a fix salary and not an outcome related one transferring the risk to the principal, who has to bear the uncertainty of the outcome but paying a fixed salary).

2.2 Corporate Governance definition and history

2.2.1. A Definition of Corporate Governance

Even if various attempts were made in this direction, until now it has been impossible to provide a unique definition of corporate governance commonly accepted by all the researches. Considering corporate governance from different points of view inevitably leads to different definition of the subject.

Because of this, the different scholar literatures tend to provide a definition of corporate governance in line of what is the focus of their subject. They thus provide different explanations of what the role of corporate governance is starting from different approaches based on their specific field. As for example scholars from management will focus more on the role of the boards and their duties, lawyers on the company law, etc.

It is important to state that none of these definitions has to be defines as wrong. There might be broader ones, including anything (and thus sometimes nothing) as "[Corporate governance is] *The way companies are run"* (Charkham (1994)). This definition cannot be considered as wrong or misleading but at the same time it does not help to understand the boundaries and the role of corporate governance.

On the other side, a definition like the one provided by Shleifer & Vishny (1997) in which they identify corporate governance as *"the ways which suppliers of finance to corporations assure themselves of getting a return on their investment"* might be too narrow. It may result very helpful considering the financing point of view and providing an identification of the ultimate beneficiary from the firm but it may leave apart some other critical information to fully understand the nature of corporate governance.

In particular a great contribution (which can be seen as the most reliable definition of corporate governance since it includes almost all the important elements) was brought by the

Cadbury commission (1992), which defined corporate governance as *"the system by which companies are directed and controlled"*. The relevancy of this definition relies on the fact that it empowers both the direction (in terms of ownership, boards, incentives, corporate law, corporate social responsibility regulations) and control (management, executives).

A further element impeding to have a sole definition of corporate governance relies on the different corporate culture and history characterizing the different nations of the world.
Considering for example the Anglo-Saxon model, which is mainly developed in the US and in the United Kingdom, the company should aim only to maximize the value for its shareholders. Thus these subjects are seen as the only ones who have to be considered as the final beneficiary of the company. Due to this vision of the firm the entire concept of corporate governance is focused on making the shareholders maximize their return on their invested capital.
Meanwhile in some countries, as Germany and France in Continental Europe and in Japan, corporate governance focuses not solely on making only the shareholders having their return, but they also implement a *stakeholder* model where also the rights and the interests of the other subjects who have direct connection to the firm (as customers, suppliers, employees, unions etc.) are protected.

2.2.2 The Actual Relevancy of Corporate Governance

Corporate Governance clearly became a prominent issue especially during the last thirty years, leading to a massive literature production on this previously poorly explored study field. Consequently a question naturally rises: why did corporate governance become such a contemporary issue?

Becht et all. (2003) try to provide an answer to this question citing six possible reasons:

- *The worldwide privatization wave:* with the term privatization wave it is defined the historical phenomenon characterized by the state owned enterprises purchase by private subjects in Latin America, Europe, Asia and in the former Soviet Block. Corporate governance became a relevant issue because of the need of select how the companies had to be controlled and owned. For example in the UK it was decided that the best way was to create a "*shareholder democracy"* (Biais and

Perotti (2002)). Meanwhile in other European countries the control was mainly transferred to large shareholders. The privatization wave also slightly increased the importance of the stock exchange. In fact many privatization transactions were conducted IPOs, which also helped to raise the attention towards the right of the minority shareholders.

- *The entrance of pension funds as active investors:* during the last decades it was experimented a major growth in the amount of money invested in the pension funds. Private investors invested their savings into pension funds in order to obtain a pension salary when retired. Due to this social relevancy it was required that those money had to be invested wisely and thus corporate governance played a prominent role in order to provide rules and guidelines to invest the money responsibly avoiding fraudulent or extremely risky uses.
- *Mergers and takeovers:* The huge takeovers and mergers wave of the eighties (in the US) and of the nineties (in Europe) boosted the global attention towards corporate governance pulling it to be the "top of the agenda" of the political class.
- *Deregulation and capital market integration:* Corporate governance rules were also promoted and implemented in order to encourage foreign direct investment in East Europe. Moreover the greater integration of the capital markets (as for example the introduction of the Euro as the unique money in the Euro zone) and the raise of equity during the nineties increased the attention towards corporate governance issues.
- *The 1998 Russia/East Asia/Brazil crisis:* The financial crisis affecting these countries put the spotlight on the bas structured investor protection system. The following restructuring and privatization process led the debate on corporate governance grow.
- *Huge scandals of major corporations:* among all the above-mentioned factors this is without any doubt the most spectacular. The collapse of huge corporations, like Enron and WorldCom (in US) and Parmalat (in Italy), driven by a hidden and fraudulent use of the finances, shocked the entire world and literally boosted the discussions on the need of a well-structured corporate governance system.

In conclusion the prominent importance of corporate governance can be viewed as the need of the firms to obtain cheaper external finance. In fact in the all the markets the need to obtain cheaper external financing is fundamental. In specific a company characterized by a

transparent direction and a wise management will send a certain message to the market. Complying determined disclosure policies improves the relations with the investors, which now can easily evaluate if the company is well governed and thus reducing the possibility that a value destroying action might be undertaken. The consequence of this transparency is that, if wisely run, a company might obtain cheaper finance because of the risk reduction brought by the decrease of the asymmetric information in favor of the company itself.

2.2.3 Corporate Governance Mechanisms

As explained before in the work, agency problems are the main issue that corporate governance aims to mitigate. The principal/agent alignment of the interest and the avoidance of a fraudulent behavior are the main concerns of corporate governance.
Several corporate governance mechanisms were implemented in order to pursue these objectives (Becht at all (2003) Thomsen (2008)):

- *Takeovers*
- *Legal Protection*
- *Large Investors*
- *Creditors Monitoring*
- *Boards*
- *Trust and Reputation*
- *Incentive Contracts*
- *External Auditors*

Takeovers

Hostile takeovers might be a very powerful instrument in order to mitigate an agency problem occurring when managers do not act in the interests of the shareholders. Mostly in a hostile takeover operation a bidder makes a tender offer to the dispersed owners of the firm, and if they accept this offer the bidder rapidly takes control of the firm. Now new owners can replace the management with a new one or take control of the old one.
Thus, purchasing the firm, hostile takeovers avoid dealing with the management to obtain the control of the cash flows and the control rights. Summing up takeovers represent a powerful instrument to replace a poorly performing management with a more efficient one.

The main drawbacks affecting this strategy are the anti-takeover defenses and the free raider problem. In fact a management not willing to leave its control position may use some very strong instruments to avoid the occurrence of a hostile takeover activity. *Poison Pills, Supermajority* and *Staggered Board* are only some of various instruments to avoid a hostile takeover. Pre-bid and post-bid defenses represent a powerful mean for entrenched management to preclude a substitution.

In fact due to the numerous and efficient takeover defenses the number of hostile takeovers attempts is very low and only in few cases the bidder successfully gained control of the target firm (Bebchuck, Coates and Subramanian (2002)).

In order to mitigate these conflicting interests sometimes companies offer to the management a *golden parachute,* which is a generous compensation because of the loose of the job due to a takeover activity.

What makes takeovers very difficult is also the need of a bidder's huge liquidity availability in a short notice. Furthermore an increase of agency costs bore by the bidding management is also expected because of the acquisition of the private benefits of control. Moreover, since takeovers can be also a political mechanism, it has to face the opposition of managerial lobbies.

Legal protection

Law surely provides a powerful instrument to protect shareholders rights. For example shareholders vote for the most important corporate matters (as mergers or liquidations) or alternatively enforce in court a manager caught stealing. But what happens if a manager does not steal but he threats the shareholders in order to be bribed not to harm the company?

The answer relies in the *duty of loyalty* towards the shareholders. Even if it is not very clear in which way this duty allows specified actions by the management or not (Clark (1985)), it is clear that threatening is for sure not allowed. Thus this rule prevents the management to constantly threat (by undertaking value-affecting actions) shareholders outside the boundaries of the contractual relationship until they are bribed not to do it.

The drawbacks of legal protection is that sometimes the set of rules ad laws might be too strict and thus creating compliances and difficulties to run the company; for example the impossibility in many countries to vote by mail and thus preclude the voting right for the minority shareholders who cannot be present at a meeting.

Large Investors

Large investors are considered to be one of the best solutions for the principal agent problem. In fact concentrated ownership incentives the monitoring of executives operations. This slightly reduces the asymmetric information and the free rider problem.

Although it may seems the solution of the problem, large shareholder ownership involves other different and even worse agency problem. In fact large ownership efficiently works only in countries with a very well structured legal framework. In case of a lack of legal protection in large owned firms there is the severe possibility of an expropriation towards the other investors (minority shareholders, employees, etc.) in specific minority shareholder may suffer from expropriation consequences. Furthermore large shareholders may effectively take the control of the firm and, due to their different risk profiles, they can run the company in their interest avoiding taking efficient investments because of their risk aversion. The consequences of concentrated ownership will be deeper discussed further on in the text.

Creditor Monitoring

When a company asks for a loan, the creditor (due to its strong risk aversion) requires a vast number of information regarding the company itself and future investment policy. Thus by asking for a loan a company is forced to provide a great amount of information useful to evaluate its governance status. Furthermore this heavily reduces management's possibility to subtract the borrowed money for personal interest or to undertake very risky and unwise projects. In fact in case of a failure on the loan repayment management and company itself will have to respond in first person bearing the risk of bankruptcy (which can be harmful also for managers reputation).

On the other side borrowing money may involve some issues for the borrowing company. Most of the time lenders may require having a sit in the board of the company, which can be considered a positive aspect under the executives monitoring point of view, but it will also reduces the decisional freedom of the company. Furthermore if a company relies too much on debt it may have to face the consequences of a *debt overhang*, which may end up in very costly restructuring procedures or, in the worst case, in bankruptcy.

The Boards

Boards can be considered as the supreme corporate governance mechanism. In fact, they formally have a huge decisional power approving corporate decisions and monitoring

executives operations. Shareholders elect boards' members in order to efficiently monitor their assets.

Formally two types of board structure exist: one tier system, commonly adopted in the Anglo-Saxon regions, and the two tiers, which has its main example in the German way of structuring boards.

Being elected by the shareholders in order to guarantee the good performance of firm boards have a huge discretional power and they are called to undertake very important decision on sensible topics: evaluate the financial situation of the company, negotiate CEO salary, select and replace the CEO, establish stakeholders policies, etc. are only some of the very important matters boards are called to decide on.

Although invested with a huge power, empirical studies note some inefficiency (Adams, Hermalin and Weisbach (2008) Hermalin and Weisbach (1996)) in the functioning of the boards mainly for two reasons.

First, even if it would not be recommendable boards sometimes include a higher number of members that are not independent from firm management. To be effective board members should fulfill independency requirements in order to avoid possible entrenchment position with the executives or with the owners. For example a retired CEO sitting in the board might be called to decide about firing someone that few years before was his colleague or his friend. This problem may lead a board on inefficient operative solutions. To avoid this issue most of the corporate laws includes specific independency requirements to select independent directors.

Second, boards meetings usually take place from five to ten times per year giving too short time to the directors to know the company and to take decisions on fundamental issues. Moreover it allows an increase of the asymmetric information's in favor of the executives of the firm by having a substantially higher information number than the directors.

In conclusion even if boards are supposed and studied to be the final solution of the corporate governance issues they result as being quite inefficient due to their structural problems.

Trust and Reputation

Having a bad reputation can be very harmful for a manager. It may affect her salary or alternatively it would make her chances to find a new job more difficult. Although reputation works only in specific scenarios characterized by an infinite time horizon where repeated games are in force. In case of a short time horizon the agent might will to exploit the principal in order to maximize his present income.

Reputation falls into a grey area of corporate governance mechanisms. In fact it can be a very powerful instrument in some cases but in other it would be totally irrelevant with no power to incentive management to operate wisely.

An example of the implications of the concept of the trust regards the financing of a project with third party money. In fact lenders also rely on he information regarding the reputation of the receiver of the money in order to make their final choice. For example track record and other instruments are useful in order if the receiver of the financing undertook moral hazard operations. Hence the managers' trust built over the years can be an important factor pushing management to operate wisely.

Incentive Contracts

Incomplete contracts (i.e. contracts where managers end up having more knowledge than the shareholders) usually determine an allocation of the residual control rights in the manager's, thus providing them a big discretional power to undertake self-interested actions.

In order to avoid this scenario it is better to guarantee management a highly dependent, long-term solution. This solution is represented by incentive contracts, which are contracts anchored to some performance measures. This contract brings the benefit of incentive management and re-aligns its interest with the shareholder's one: as positivist researches assess "*When the contract between the principal and agent is outcome based, the agent is more likely to behave in the interests of the principal"* (Eishenhardt (1989)). The explanation relies on the fact that rewards both for principal and agent depends on the same outcome: firm's performance.

Furthermore performance measures are usually easily related to management actions in order to easily enforce the contracts in court.

The main drawback of this mechanism is that it can create self-dealing opportunities for managers. For example if managers know that stock price will rise they might push an unmotivated board to re-negotiate incentive contract or alternatively managers may manipulate accounting in order to show higher profits.

External Auditors

External auditors are mainly external companies hired to audit on the firm's accountancy, stating if it provides a "true and fair view" of company's financial situation. Briefly auditors are another tool sent by shareholders in order to check whether the company was well conducted by managers and board.

Auditors thus contribute disclosing relevant information about the company for the investors. The fact that auditors guarantee the reliability of the firm's financial status for the investor's population provides them a strong incentive not to issue biased work because their reputation would be damaged.

Nevertheless auditors cannot solely solve corporate governance issue. Since auditors are not a free resource there is a limit to their services. Moreover, due to the switch from historic cost accounting to market based valuation managers have more possibility to influence auditors. Since auditors are paid by the company auditors may provide "creative finance" works to serve manager's desires.

2.3 Corporate Governance Structural and Cultural Differences

2.3.1 Implicit and explicit contracts: whom does the firm belong to? A Theoretical approach for Shareholders supremacy Vs Stakeholders supremacy

Theoretically corporate finance's definition of the firm as a nexus of contracts (Jensen & Meckling (1976)) has an important implication in corporate governance. Including or not implicit contracts may substantially change the point of view about whose value should be maximized by the firm.

The firm as a nexus of explicit contracts

Considering the firm as a sole nexus of explicit contracts then it exists only as a contractual relationship and it worthies as much as the mere sum of the value of the individual contracts it is composed. In this scenario also liquidation due to financial distress should not affect the firm's overall value since it is represented only by the sum of the contracts.

If this vision of explicit contracts is accepted then the discussion on who should have the decision rights is consequential: the only residual claim for a nexus of explicit contracts is equity (Zingales (2000)). Thus this vision of the firm strongly empowers the shareholders supremacy because being the ultimate residual claimants they have the right to make decisions. Although by a legalistic point of view shareholders' decisions influences the payoff of many other members of the nexus, the explicit contracts solve this issue specifying the future payoff contingencies of the other members of the nexus. In fact since they future payoff are already established they prevents the creation of contentions for voting rights allocation because the two parties know ex-ante the contractual outcome. Thus the other

nexus members are indifferent allocating the control rights to the shareholder because they would undertake the same shareholders action.
Anyway this approach creates a paradox because in order to valuable control rights should be able to alter the distribution of the payoffs (which might not be the desired one by the other nexus parties) and thus because of that the other parties of the nexus are no longer protected.

The firm as a nexus of explicit and implicit contracts
Differently from the explicit contracts approach, the firm as a nexus of implicit and explicit contracts considers contracts that cannot be enforced only by signing a material paper. Even if this might seem a minor detail it substantially changes the entire concept.
Now a firm is not anymore the mere sum of the explicit contracts it is composed but it becomes a unique mix of factors (as reputation for example) leading to a superior (or inferior) value compared to the sum of its contracts.
For example now a liquidation procedure may imply the break of implicit contracts like workers' will to invest, thus destroying the efficiency and value of an implicit relationship. Breaking implicit contract leads to the loss (or gain) of value that cannot be explained only by breaking explicit contractual relationship.
This theory has also a huge implication regarding corporate governance matters. It provides a theoretical background for the entire *stakeholder* theory. If the explicit contract theory provides a backbone for the *shareholders supremacy*, implicit contract includes the stakeholders as residual claimants besides equity holders.
A firm may have implicit contract relationship with other subjects like customers, employees or suppliers, which are usually not considered as part of the corporation. Including these subjects as residual claimants it becomes unclear if only the shareholders should own the supreme right of control. Pursuing some self-interested value maximizing operations, shareholders may affect stakeholders' wealth breaking implicit contracts.

The theory of explicit and implicit contract thus provides a strong background for the subsequent discussion about the corporate governance differences around the world. In fact in countries like US and UK, shareholders supremacy is considered to be the main objective of the firm, meanwhile in Germany and France for example, shareholders value maximization can be pursued only if stakeholders wealth is preserved.

2.3.2 Corporate Governance in the United States and United Kingdom

United States and United Kingdom clearly represent the most evident examples of the *Anglo-Saxon Model*.

Differently from other models characterizing some Continental Europe countries, in this model the main objective of a company is maximizing shareholders' return (always complying with national laws and regulations). For this reason it is mainly defined as a *shareholder-centric* model (Rock Center for Corporate Governance (2008)).

Another relevant aspect characterizing UK and US regards the ownership distribution. Although in some US corporations ownership was concentrated in the hands of the founder or the state (Eisenberg (1976), Demesetz (1983), Shleifer and Vishny (1986)), the driving path is characterized by a very dispersed ownership. In United States and in United Kingdom it is very uncommon to encounter large shareholders. In fact due to the taxation system the blockholder formation is strongly un-encouraged.

In the two countries the shareholders are mainly institutional subjects aiming to diversify their investment portfolios.

Due to the very dispersed ownership structure the board plays a major role as a corporate governance mechanism to ensure that the management, hired to run the company, will act in the shareholders' will. Both countries adopt the one-tier board system: company's shareholders elect the board composed by non-executive members, which subsequently nominate the executives of the company.

The United States

In the United States professional management runs most of the companies. In fact Chief Executive Officers are usually not the founders or the controlling owner of the corporation but professional manager hired to efficiently run it. As explained before the board is the major mechanism in force to control executives' behavior.

Boards in U.S. have four main duties:

- CEO selection
- Selection of new candidates for the board of directors
- Evaluation of operational execution, strategy, capital structure and financial statements
- Company's complying with the regulation, laws and listing requirements

The board of directors can be composed both by executives and by non-executives directors but usually the majority of the board members are non-executives selected on the basis of their personal experience or knowledge in the field. Furthermore, in order to ensure a further level of independence from the senior executives, boards are forced to have a majority of independent board members. Although this requisite of having a majority of independent directors, NYSE do not provide a legal restriction to the definition of *independency,* limiting its intervention to describe as dependent the directors who are influenced by material or charitable business and other relations with company's representatives. In order to bypass these rules sometimes companies issue dual-class shares in order to keep one shareholder (most likely the founder) as the ultimate owner of the decisional power.

In order to ensure the integrity of public financial statements another subject is selected to provide a further feedback: the external auditors. External auditors' role is to review company's internal controls (due to the implementation of the Sarbanes-Oxley law) and test whether the accounts fulfill the GAAP (Generally Accepted Accounting Principles). If the company successfully comply with the rules an *unqualified opinion* in the company's annual report, meaning that they during the review procedures they did not met any misleading statement.

On the contrary, even if it is a very uncommon, if the external auditor meets a misleading statement or the impossibility of prosecute a profitable activity it issues or a *qualified opinion* or *going concern*.

The United Kingdom

United Kingdom model (deriving from the *common law* either) shares a lot of commonalities with the United States model. It is also *shareholders-centric* model, thus focusing on the value maximization for shareholders. Even if the law does not strictly determine it, UK's companies mainly choose to adopt the one-tier board system, and the board itself has mainly the same characteristics and functions of the United States ones.

United Kingdom also developed a set of standards for the London Stock exchange, the *Code of Best Practices (*mainly referred as the *Cadbury Code*). However, differently from the United States, this set of standards was not legally mandatory for the listed companies but they were required to issue and annual report stating if they were complying with the Code's standards or not. If they failed to comply with the Code it was required a provision of an explanation of the reasons leading to the missing compliance.

Differently from Germany and the other Continental Europe countries, the high level of investor protection both United States and United Kingdom is considered as the higher among most of the countries.

2.3.3 Corporate Governance in Germany and in other European countries

Germany

Differently from the Anglo-Saxon model, Germany is characterized by the adoption of a *stakeholder-centric* model. The basic assumption of this model is that a corporation does not have the sole aim of maximizing shareholders' value but it has to be pursued in respect of the interest of the remaining universe of stakeholders having interest and relationship with the firm.

German companies implement a two-tier board system, which strongly separate the monitoring part and the executive one. Shareholders directly elect a part of the members of the *supervisory board (Aufischtsrat)*; the remaining part is elected by the employees in order to have a direct representation on the board (highlighting the stakeholder-centric characteristic, predominant in the German model). Supervisory board has to constantly monitor the other board and take the major decisions like mergers, massive capital expenditures, dividend payment and firm performance.

Subsequently the supervisory board elects the *management board (Vorstand)*, which is composed by the executives and has the role of undertaking everyday operations.

Differently from the one tier system where executives could be part of the board of directors, in the two-tier system no executives are allowed to sit in the supervisory board.

Another distinctive characteristic of the German corporate governance is the different ownership structure of the corporations. In fact if in the US and UK dispersed shareholders are the most common ownership structure, in Germany (as well as the major part of the world) the ownership is more concentrated and more bank dependent. Founder family members, bank and insurances representatives compose many supervisory boards and firms mostly have a large shareholder ownership.

The importance of banking financing grew stronger because of the post World War II when corporations were heavily dependent on banking loans more than on capital markets. By that time companies borrowed money from the banks offering parts of the corporation as a collateral, and, furthermore, bank officers received a seat on the company's board. This led to a foundation of a solid, long-term relationship still characterizing the German Market.

Differently from other parts of the world where this practice is forbidden, in German banks are allowed to have controlling stakes in non-financial firms, thus leading to the creation of the concept of *Universal Bank* (i.e. a bank that has a lot and very diversified branches).
However the recent globalization trend is shifting the attention towards the development of a strong capital market as a source of financing. Thus it seems that a destabilization process of this governance relationship is slowly advancing also in the German banking based market, pushing the focus more on a shareholder-centric model (Lacker and Tayan (2008)).

Japan

Similar to Germany, Japan's corporate governance system has its roots in post World War II scenario and it is strongly *stakeholder-centric*. During the reconstruction conducted by the Allied Forces (especially by the United States) the previous corporate governance model of *zaibatsu* was forbidden. Zaibatsu was a model based on huge industrial conglomerates accounting as the first productive force in pre-war Japan.
Due to the prohibition of this model, Japanese market reacted stimulating the creation of the contemporary model of *keiretsu*. In Keiretsu the corporations still have minority stakes in suppliers and business affiliates and (as in Germany) they are very related to a bank. In fact most of the times a bank owns a minority stake in the corporation. This "chain" is considered to be very efficient because it stimulates the creation of relationship among the various levels of the chain.
The adopted board system is one-tier, and the members of the board are mostly insiders, often including bank representatives and big suppliers or customers. In order to avoid the potential issues deriving from this composition of the board, corporations usually enabled a third party composed by external advisors to provide monitoring services.
Commonly as German market, Japanese market is orienting towards a capital market development, reducing the relevancy of banking loans. Due to their culture based on cooperation and respect, Japanese companies are facing a very though challenges responding to the aggressive capital market pressure.

France

Differently form Germany and Japan the corporate governance structure of French firms follows another historical path. More similar to Italian historical background, French corporate governance model was severely influenced by the strong presence of the State as

the major shareholder in most of the "core" French firms. Only after the privatization wave, government's presence was reduced.

French firms as well mostly rely on the banking system as the primary source of financing for the corporations, and as well as the previous two cases the globalization forces are pushing towards a more developed capital market as the primary financing source.

During the last years several actions have been undertaken in order to improve the lacking financial system; several incentives were issued in order to stimulate the growth of the capital market, as for example the incentive provision to expand the public ownership. In fact, at least formally, French corporate law is considered to be protective towards the minority shareholders (Enriques & Volpin (2007)).

Regarding board structure French companies have the possibility to decide which type of board system they can adopt: both one-tier and two-tier boards are eligible options depending on the company's regulation. A peculiar element of French board structure is that company's CEO usually corresponds to the chairman of the board (whether allowed by law). This correspondence would not be allowed or considered as harmful in most of the other described cases.

2.3.4 Corporate Governance Reforms in United States, United Kingdom and France

The Sarbanes-Oxley Act

Approved by the US congress on the 30th of July 2002, Sarbanes-Oxley act settled a new set of accounting and investor protection laws. Its sudden implementation was mainly a reaction to the big Enron scandal and the stock price collapse due to the Internet bubble.

The Act included eleven sections providing strict rules varying from disclosure matters (as for example the disclosure of financial reporting's "control of controls systems", auditors independency, whom should sign the financial reports) to various prohibition or protections of some operations.

Presented by the political forces as the definitive "deus-ex machina" of corporate governance reforms it was severely criticized by all the economic operators.

Firstly the act provides only a complex contribution to a field, which can be easily regulated by company law and codes of best practice. Its high level of complexity, its severe application and the severe punishments created an anxiety among the market actors.

In conclusion, even if it was born under the "investor protection star", Sarbanes-Oxley Act ended to be as a major burden for the American companies, which now had to comply with a

very complex and ambiguous set of rules, limiting beyond any possible reason companies efficiency.

The Cadbury Commission and Higgs Report

After the big financial scandals of huge corporations (Polly Peck, Bank of Credit and Commerce International and Maxwell Group) in 1990 British government commissioned to a committee headed by Sir Adrian Cadbury to develop a commission. The committee's goal was to provide a benchmark of recommendations on corporate governance matters.

The final work issued in 1991 was composed on self-regulations standards, which differently from United States (where the adopted policy was to issue a strict set of rules where the non compliance led to hard punishments), based on the "*comply or explain"* policy. Adopting this policy they were convinced that good practices would have driven out bad ones. Companies were not legally forced to adopt the standards but they had to state in their annual report if they were complying with the set of recommendations and if they were not they had to explain why there were not able to do that.

Cadbury commission provided 19 recommendations in their *Code of best practices* varying from CEO and chairman separation, independent directors presence on the board of directors, board conflict of interest reduction and internal control effectiveness review.

Anyway some critics were moved to the Cadbury commission work: especially it was considered as being too weak and vague and especially the voluntary adoption of the recommendations was considered to be too inefficient.

In order to avoid this issue British government asked to Sir Derek Higgs to evaluate the quality and effectiveness of non-executive directors. In 2003 Higgs report was published it appointed 7 recommendations:

- The executives had to be selected in a meritocratic scale and within a big number of candidates
- The role of chairman and CEO had to be kept separated
- The importance of the independent directors had to be enforced among the non-executives directors.
- Also the non-executive members had to interact with the major shareholders
- Each executive member's performance had to be evaluated once a year by the shareholders
- Non-executive board members' legal responsibilities had to be better defined

- Independent and non-executive members of the board had to be the majority in the candidate's proposals, remuneration and internal control committees. No board member was allowed to sit at the same time at all the committees.

The Vienot Report

The privatization wave stimulated the French government to discuss about the corporate governance issues arising if no regulations were issued. As a response it was created a commission headed by Marc Vienot, vice-director of Societé Generale, which issued the final report in 1995.

As Cadbury report, Vienot report clearly stated from the beginning that it would not have set legal restrictions or any other mandatory regulations but it would have provided only recommendations relatively to governance matters like: executives nomination and election, executives board and chairman, executives board composition and organization, remuneration, audit committee, etc.

The guidelines definition were mainly general principles because of the conviction that it was impossible to find an universal solution for all the companies but, alternatively, each firm had to evaluate and select its owns optimal strategy.

In order to provide a further integration of the first document French government decided to delegate the creation of a Vienot report II, which briefly evaluated the efficiency of the first report and subsequently provided a further integration on *transparency* principles and *good governance* in order to improve the quality of investors relationship.

CHAPTER 3: CORPORATE GOVERNACE IN ITALY

Italian Capitalism can be considered a great example of a latecomer civil law country in the industrial development. As studies pointed out, Italy has a disproportioned developed S-sector (small business sector), meaning all of those firms with 5 to 200 employees, mostly industrial, producing for domestic and foreign markets.
In fact most of these firms achieved greater stability and successful productivity than the large ones. This was possible due to the very complex and traditional products they produce, their flexible organization employing highly skilled labor and their inter-firm participation in groups, providing sustainable coordination especially when belonging to the industrial sector (Barca 1996)).
The macro-environmental evolution, the political pressures and the cultural scenario over the decades brought Italian entrepreneurs to rely on a pyramidal structure based on family control still enforced nowadays.

3.1 Historical background of Italian Corporate governance

3.1.1 Italian Corporate Governance until 1936

As well as in all the other countries, corporate governance in Italy has been severely influenced by its own historical background.
At the end of the 19th century Italy was still a "latecomer" aiming to industrialize. The ruling class had industrialization at "the top of the agenda" because it was considered fundamental in order to gain further national power and international political competitiveness (Amatori and Colli (2001)).
The beginning of the Italian industrialization process started at the end of the 19th century when Italy entered in an Austrian-German alliance to contrast France. This alliance led the German model of corporate governance (strongly based on banking financing) to be the first step of the Italian industrialization process: the "universal banking model" became the main stimulus for the Italian industrialization. Banca Commerciale Italiana and Credito Italiano represent the main example of Germanlike universal banks applied to Italy. Founded in 1891 with German capital, the two financial institutions quickly became the most important banks acting in the national market (Bianco and Casavola (1996)).

Although these types of banks existed since the early stages of the Italian reunification of 1861, the German corporate model influenced the growing Italian system to the extent that, by the beginning of the 20th century, very little difference could be noticed between the largest Italian firms and the recent Anglo-Saxon companies (Aganin and Volpin (2003)).

Until the First World War Italy experimented a massive increase in the industrial operations and the two banks covered a major role for the industrialization process, providing capital for the core markets of steel and electricity and for the entrepreneurial activities. Nevertheless when the banks had to face liquidity crises the State had to intervene in order to solve those situations, which could potentially become critical for the economy. An intervention of the State was firstly seen in 1887 when it saved the steelworks of Terni. In that case the State printed money in order to cover the debts of the company.

Subsequently the national Government intervened in other three situations: to save the steel industry in 1911, in 1923 to save the third and fourth major credit institutions (Banca Italiana di Sconto and Banco di Roma) but the most relevant is the one that occurred in 1933.

In fact by that time the Italian industry was severely affected by the so-called "Great Crisis", a great economical depression hitting the financial system in a moment of industrial and financial concentration. The collapse of the poorly structured stock market, hit a financial system mainly based on cross-holding ownership and started a domino effect, which elevated the magnitude of the crisis' impact (Barca and Trento (1997)).

This chain of events forced the State to massively enter in the market as a dominant player to try to stabilize the environment, which, by that time, was far from being stable.

Even if the Government had to intervene with some rescue operations, before the 1930s its the presence in the stock market had been very limited (Aganin and Volpin (2003)) but with the final intervention in 1933 the State, overwhelmed by the weight of the Great Crisis, decided to create the IRI (Istituto per la Ricostruzione Industriale, i.e Institute for the Industrial Reconstruction) which took over the three major banks (Banca Commerciale Italiana, Credito Italiano and Banco di Roma), thus becoming the prominent force in the Italian stock market. Purchasing the three troubled banks, the Fascist Government was able to manage the portfolio of companies previously related to the three banks by short and long-term loans.

In the end, after taking over the three institutions, the State had a control over 40% of the national shareholding capital, establishing a massive presence in all the core sectors of the Italian industry: steel, electricity, chemicals and machinery.

3.1.2 The Abandon of the Universal Banking Model and State Entrepreneur

In order to avoid further crisis scenarios the Fascist Government implemented a strategy, which significantly mutated the previous economic structure. In 1936 an act was issued forbidding banks to hold industrial companies' equity and moreover long-term borrowing, leaving these types of operation to specialized financial institutions. This can be considered as a major turning point in the corporate governance history of the nation: the German "Universal Banking" model was abandoned and the central role of the Government became the prominent strategy. In fact this prohibition lasted until 1990 when the Treasury Minister Giuliano Amato issued an act allowing banks to perform again as Universal banks (despite having some limitations).

The reasons of the Universal banking model failure lay in the fact that Italy probably was not ready to keep up with this type of structure. The GDP per capita was almost one half of the other major European economies like France and Germany. Thus banks had to heavily rely on expensive international capital. Moreover since the Italian corporate system was relatively young, entrepreneurs were used to undertake large-scale project without the necessary capabilities and strenght to resist to the opportunist behavior of speculating with the money obtained through banking loans.

As explained by Amatori (2001) the best solution could have been the total liberalization of the market, stimulating a growth of the stock market as the instrument to fulfill the gap between the industrial financing need and private savings. But evidently this solution would have strongly clashed with the political, cultural and economic conditions present in the entire continent. Furthermore the previous stock market crisis of 1907 drove by the speculative operations already undermined the public trust on the stock exchange's real effectiveness. Thus the development of the stock market remained stalled until the 1980s when the need for its implementation was fundamental and thus could not be postponed anymore.

Without the possibility of steadily rely on the stock market, the only possible source of financing for the industries laid with the State, which started acting as a real entrepreneur.

It's worth noticing that differently form other countries in the world where State has a major role in the economy due to a massive nationalization policy, in Italy the presence of the State in the economic environment is in reality a consequence of the rescue strategy operated on the Italian industrial sector, and not a deliberate pursue of a nationalization policy.

3.1.3 The Postwar Period and the State-Owned enterprises

At the end of the war Italy was a different country, Fascism and the Monarchy had disappeared making space for a new Republican Government ruled by communist, liberal and catholic parties, and a new Constitution was formed. Even if a lot of major changes occurred, Italian capitalism did not appear to be significantly mutated; even the Economic Committee of the Constitutional Assembly realized that some changes had to be made but no significant reforms were undertaken (Barca 1994, Cap VIII).

Anyway during the 1950s Italy experienced a massive economic growth, always referred as the "economic miracle". During this period the state consolidated (and increased) its presence on the economic market with the foundation of *ENI* (*Ente Nazionale Idrocarburi,* National Hydrocarbon Agency) by Enrico Mattei (who had to face strong opposition by American companies aiming to exploit the Italian resources). The company, which had to manage the oil, chemical, and petrochemical sector, was the main example of State policy being the reference point for both political and economical power. The managers who were considered the best were hired by the State to run state-owned companies. IRI continued to act more as "technical advisor" on all the economic policies rather than a proper corporation.

During this phase the other non-State-owned companies were mainly family run companies able to expand due to the presence of investment bank *Mediobanca*, a formerly State owned financial institution founded in 1946 that soon after gained full independence (Barca and Trento (1997)).

The stock exchange was still not considered as a primary financing source, mainly because the industries were able to self-finance. Through self-financing the companies were able to undertake the necessary investments to renovate the plants in order to cope with the increasing international demand for their products. In fact due to low salary rates earned by Italian labor, the products could be sold at favorable conditions in the international markets.

During the economic miracle of the 1950s the State-entrepreneur seemed a very effective model to compare with the German and Anglo-Saxon ones. Italy's economic growth was massive; unfortunately (and differently from the other two models) the Sate-owner model included some structural issues, which have to be considered in order to fully understand the reasons on this economic miracle.

Firstly during this phase the leaders of the state owned enterprises were out of the public control thus corruption and political support became a common path to follow in order to pursue industrial strategies.
Moreover the political control over the key role sectors of the economy sometimes forced decisions mainly for political reasons rather than pursuing economic ends. Thus state-owned companies were heavily subjected to political goals and constraints, which ended up chocking their real productive capabilities.
In conclusion, the low wage rates earned by the workers were the by-product of an unbalanced power situation in favor of the bosses. In fact after World War II labor unions were either not formed, or they were still not powerful enough to cope with the requests of the industrial bosses who "exploited" the situation in their favor. Lowering production costs the products could be sold at a very competitive price. This imbalance continued also during the next decades until, during the 1970s, the Unions "conquered everything" (Amatori and Colli (2001)) but since they were not able to manage this situation efficiently, it went out of control leading to extremely violent clashes within the different social classes and also episodes of terrorism.

All this aspects became prominent starting from the beginning of the 1960s. During this phase the rapid growth experienced after World War II started to decelerate, highlighting the lack of a stable economic environment able to cope with the new market conditions.
In 1958 a new Government coalition based its economic policy on changing the role of ENI and IRI. If until that moment the two institutes had to stimulate the renewal and the reconstruction of the industrial network, now the two companies had to aim to monopoly ends, foster industrial networking, employment objectives and improve the Southern part of Italy's (also referred as "Mezzogiorno") industrialization.
In order to pursue these policies new agencies were created in order to establish a monopoly in all the critical sectors of the economy: ENEL for electricity (National Electric Authority), in 1958 EGAM for mining and EAGAT for engineering, in 1962 EFIM was created to control railways.
In order to control all these new agencies an Inter-Ministerial Committee for Economic Planning was established in 1967, but the only consequences it brought to the system were confusion and extreme complexity (Barca and Trento (1997)).
The new control system also caused a new issue; the tangled governance relationship linking the State to the public companies, neared politicians to the top management of companies.

Thus loyalty, individual relations and favoritism behaviors took place, reducing on one side the politicians' capabilities of controlling top managers' operations and on the other hand the independency of corporations to pursue economic ends and be performing.
Since State-Owned enterprises had also to achieve social goals, the "Mezzogiorno" issue represented a political target to target. In order to encourage its development, Italian Government issued an act stating that ENI and IRI had to invest 40% of their resources in the southern part of Italy. In order to comply with the new requirements ENI had to expand in the general chemical industry; this forced expansion caused a huge financial and industrial damage for the entire company.
The mix of these factors combined with the deceleration of the economic growth, persuaded the companies to focus more on short-term objectives (as employment policies and salvage operations of other firms in financial distress).
In order to be able to follow this strategy of pursuing social goals by using the firms as principal means, the Government fixed a very soft Budget constraint; in the very end it is possible to argue that no budget constraint almost existed at all. State-Owned companies were allowed to freely borrow, with the back covered by the issues of public Government bonds.

During the period of time between World War II and the 1980s, although Italy experienced a huge growth driven by the global post-war reconstruction trend, it also showed the main structural weaknesses, which prevented Italy from becoming one of the front row players in the economic scene for the following years. If some economic institutions provided a more stabile backbone for the economy, most probably Italy would have achieved the same industrialization miracle that occurred in other countries as Japan.

3.1.4 From the 1970s to the 1990s

During the 1970s, as well as all the other countries in the World, Italy was involved in two major oil crises. These two crises severely affected the productivity of the major Italian corporations and thus created a further burden for Italian economy in general.
An uncontrolled increase of the inflation was experienced, worsening the general financial profile of the country. Companies could survive only by increasing the short-term indebtedness, which had to be continuously renovated with banks. In fact after 1936 banks

were prohibited to provide medium and long-term debt to the industrial companies[2], and the continuous renovation of the short-debt was the only way to achieve some financing.

In fact, due to the weak cross-shareholding governance structure, companies were not able to rely on sufficient internal finance anymore. Although the supervising agency for the stock market (*Consob)* was created[3] in 1974, also the Stock exchange was still too undeveloped and not considered as a major source of finance[4].

Thus Italian companies were still heavily relying on banking loans as the primary source of financing, despite the constraints posed by the 1936 law, which continued tightening their indebtedness capacity.

Due to the lack of a market for capital exchange and the high level of inflation, all the Public expenses were financed through the issue of Treasury bonds, which were less risky and provided a higher return than the stocks and, consequently, more attractive for the investors.

Moreover the Italian capitalism was suffering also due to the huge clash occurring between industrial employees and their bosses. As explained before, the fight between unions (aiming to achieve better salary rates for the employees) and heads of the companies became harder in the 1970s. In the end the new wage rates were more favorable to the employees thus deleting one of the other factors on which the economic miracle of the 1950s was based on.

The beginning of the new decade saw a great improvement in the sector whose presence was missing during all the previous decades. In fact during the 1980s an impressive improvement of the financial market brought great benefits for the entire economic system, which, after the "dark decade" of the 1970s, experienced a new growth.

The new political stability, the reduction of the inflation (thanks to the restrictive monetary policy) and the internal reconstruction of the main industrial groups, set the fundaments for the financial market improvement of this decade.

After suffering from the adverse environmental conditions of the 1970s, the main industrial groups were able to renovate themselves during the 1980s. The reconstruction process started within the firms themselves by adopting policies of internal restructure; secondly technologic

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[2] The only institutions allowed issuing long and medium-term loans were the *Istituti di Credito Speciale* (Special Credit Institutions), which were allowed to subscribe these type of financings only to State-owned enterprises (Amatori and Brioschi (1997)).

[3] Although created in 1974 providing a signal that stock exchange was starting to be considered as a useful financial source, it took much more time for Consob to achieve the necessary power to become a proper instrument of supervision.

[4] At the beginning of the 1980s the number of firms quoted in the Milan Stock Exchange were 138 while in France 535 and in Germany 450 (De Cecco and Ferri 1996: Table 2a and 3a, 32-33).

improvements were applied to the production, increasing its efficiency, vertical integration and internationalization operation were undertook; in conclusion also the M&A activity grew considerably during this period.

Meanwhile, a finally efficient financial market sustained this process, the cash flow production was used to reduce the indebtedness level, while a growing stock market allowed the major groups to rely on it as a source to fulfill their financial needs.

The vertical integration and the M&A activity are the most interesting phenomenon of this phase. In order to rise sufficient founds for the innovation process most of the Italian major groups started selling quotes of the controlled subsidiaries but keeping the final control of the firm. Thus, although having sold quotes of the various subsidiaries, in the end the ultimate owner had a majority stake allowing him to control the head company and all its subsidiaries, which subsequently had other subsidiaries controlled with a majority stake and so on.

With this practice, major shareholders (which usually were single business men or families covering the role of internal directors of the company) were able to establish a sort of pyramidal group composed by "Chinese Boxes" allowing them to keep the control of the entire group with a relatively low investment and with less risk.

This pyramidal structure is an extremely important consequence of this period because still nowadays it will characterize the entire governance structure of Italian firms.

In fact this pyramidal model is still very common not only in the small business firms but also in the major and quoted ones (Amatori 2001).

Brioschi et all. (1990) provide a clear picture of the corporate governance model in force the end of 1980s:

> *"[t]he data available upon the separation between property and control inside the main subholdings and other listed enterprises highlight the particular nature of the Italian industrial capitalism which in fact maintains its characteristic oligarchic family capitalism. In fact the main controlling shareholders are still clearly coincident with a small number of families, some of ancient entrepreneurial tradition, like the Agnelli, Pirelli, Orlando and Falck families, and some others relatively new, like the Ferruzzi, De Benedetti and Ligresti[5]".*

[5] Brioschi, Buzzacchi, Colombo 1990:165, "Gruppi di imprese e mercato finanziario. La struttura di potere nell'industria italiana" *NIS ,Roma*

So even if the financial market was subjected to a great innovation by not relying anymore only on banking and institutional investments, companies' ownership structure remained related to the past. The different types of models as the Anglo-Saxon based on widely owned *public companies* hence were not implemented in the Italian corporate system.
At the end of the 1980s a huge inter-firm network of alliances, cross-holdings, and interlocking directorates characterized ownership structure in Italy. Minority shareholders protection and hostile takeovers were absent, meanwhile the main merchant banking institution created after the World War II "Mediobanca" acted as the pillar of these networking alliances strategies. This bank, (a formally State-owned institution, which in reality acted as an autonomous organ) was placed at the centre of the networking system as a mechanism of stimulus and control. This system enhanced the stability of family control among the major corporation fostering the networking relations among the companies, and stimulating the mutual protection policies among the various groups.

3.1.5 The privatization wave of the 1990s and the actual scenario

At the half of the 1990s a high level of ownership concentration, pyramidal groups and interlocking directorates characterized Italian situation. The description provided by Bianchi, Bianco and Enriques (1997) gives a clear example of what was the corporate structure by that time:

> *"a)...a high concentration of direct ownership both for not listed and listed companies [with] a very limited amount of separation between ownership and control; b) the analysis of direct ownership and of the identity of owners reveals that a major role is played by families, coalitions, the State but especially by other companies ; the largest share of not listed and listed companies is held by other non-financial or holding companies... ; c) this phenomenon is accounted by the fact that more than 50% of Italian industrial companies belong to a pyramidal group : the reason for the adoption of this organizational structure...is mainly linked with the possibility of controlling a vast amount of resources with a limited amount of capital...hence it is a means for achieving separation between ownership and control... ; d) therefore in Italy pyramidal groups led by families, coalitions and the State have substituted other forms of separation...this structure, reinforced by cross-ownership and board interlocks, has allowed a stable*

> *control...with a limited amount of control changes, in particular of hostile takeovers"*[6]

Thus Italian capitalist model was still mainly based on the pyramidal model of corporation. The leading elements for the flourish of this particular model were a) the possibility of exerting control with a limited capital investment, b) the public incentives for the industrialization of undeveloped areas drove a lot of entrepreneurs to open subsidiaries in those areas in order to exploit the particularly advantageous conditions and c) the low investor protection in favor of minority shareholders allowed the controlling subject to defraud the minority shareholders.

Another element characterizing the corporate governance system during those years was the very close relationship between directors and managers. Directors were mainly directly subjected (or alternatively they were the same person) to the owners. Thus non-executives board members had the role of representing the major shareholder and the executive directors were mainly related to the President of the board.

Regarding board it was also very common to see directors sitting in different companies boards. The interlocking directorship grew as a way of contrasting the 1936 law prohibiting the long term financing to the industrial firms by enhancing personal links.

At the half of the 1990s the State-entrepreneur presence was becoming an un-bearable element for the economical system. The State-owned enterprises were huge institutes affected by the impossibility of being efficiently productive. The political issues and social aims represented a burden for the companies, which continuously had to borrow public money in order not go bankrupt. This huge inefficiency flew into a national debt crisis. By 1992 Italian debt/GDP ratio reached 1.11 leading to currency devaluation, in 1993 the GDP was negative and the amount of losses of IRI were estimated as 30 Billion of Euros (Amatori 2001). The population started considering the public firms as an inefficient burden for the economy and mainly responsible for the national crisis. Furthermore the Maastricht Treaty was going to start the European economical unification and Italy wanted to play a major role in the new upcoming scenario.

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6 *Bianchi, Bianco and Enriques 1997:2-3*

The solution proposed by the Prime minister Giuliano Amato was then to implement a privatization policy, not only to raise sufficient funds to limit this uncontrolled public indebtedness, but also to improve the efficiency of the State-owned companies.
The firs step was undertook in 1992 when all the public companies were transformed to stock companies and their shares were moved to the Treasury minister.
The privatization process went on and at the same time further policies were implemented in order to raise the competitiveness and to enlarge the stock exchange.
In 1994 a set of corporate governance rules and stock allocation and issue was emanated and thus the full implementation of the privatization process was completed.
Even thou being subjected to a strong criticism the privatization wave of the 1990s achieved a great success. From 1992 to 1997 the State earned 90 Billions Euros through the privatization process and the privatization of Telecom Italia in 1997, with its almost 20 Billions Euros, was the highest privatization operation of the year.

Italian privatization wave was also a by-product of the State need to get ready for the Maastricht Treaty rules, especially those regarding State involvement in the economy and monopolistic positions. Thus the leading force for the privatization process was the extreme need of re-configuring the economy starting from the State-owned enterprises, in order to be able to achieve also a major role in the new European system that would have been lately created.

The privatization wave can be considered as the last major turning point until the recent days. It provided a strong stimulus for the discussion about the corporate governance system of the new privatized companies.
Furthermore during those years a process to protect minority shareholders started with the emanation of the so-called “Draghi Reform” in 1998. In fact, although significant improvements were made to improve the economical efficiency of the country, in 1994 Italy was still ranked as one of the industrialized countries with lower protection for the investors (La Porta et al. (1998)).
Thus even if great improvements were made during the 1990s decades, a lot of work and reforms had to be made in order to provide an efficient governance control.

3.2 Family and Pyramids in Italian Capitalism

Berle & Means (1932) and Jensen & Meckling (1976) (and subsequently Sheifler and Vishny (1999)) firstly highlighted the corporate governance issue regarding the separation of ownership and control in widely held companies. They also argued that a possible solution for this problem relied on a more concentrated ownership, because it seems unlikely that managers owning large equity block may undertake actions ending in a reduction of their share value (Morck & Yeung (2001)). Even if this vision might seem logic, the practical evidences from the analysis of companies characterized by this type of structure suggest quite the opposite. Even thou reducing the agency problem occurring between owners and managers, modern literature (Morck & Yeung (2002) and (2004), Bianco & Casavola (1999) and others) tends to highlight, although mitigating the owner- manager issue, how concentrated ownership might end in the creation of further, and even more potentially severe, problems for the efficiency of the firm.

Meanwhile in the United States and in the United Kingdom the prevailing system is the one based on the widely dispersed ownership, in most of the other countries large firms are organized business groups at which top there is usually a wealthy family (La Porta (1999)). As part of one of those countries Italian capitalism can be considered as ne of the best examples of this type of governance structure. In fact Italy provides a very good example of a civil law based country where ownership is characterized by a high degree of concentration and there is a relevant risk of expropriation of minority shareholder by the majority ones (Mancinelli & Ozakan (2006)).

The historical relevance of the pyramidal groups in Italian economic system steadily increase during the during the privatization process. In fact due to the lack of formal rules and institutions Italian governance system had to rely on state ownership and, after the privatization process (leading to a significant reduction of the presence of the State in the economy), on a code of implicit rules and relationships, provided by families and coalitions, ending in a complex network of pyramidal groups.

3.2.2 Families and Pyramids

3.2.2.1 A description of the pyramidal system

The first step in order to understand why in civil law countries pyramidal structures involve such great issues is to describe what a pyramidal structure is and how it is formed.

Some authors provide a definition of pyramidal structure, helping as a first step to understand this governance structure. Barca (1996) defines pyramidal control the situation where "[…] *some companies (from two to several hundreds are controlled by the same entrepreneur via a chain of property and control relations"*[7] alternatively Kendall and Sheridan (1992) defines pyramidal groups as "*a cascade of companies which can exert control trough a complicated shareholding structure at a minimum cost"*[8].

Thus pyramidal structures are models characterized by a high degree of ownership concentration. In fact most of the pyramidal groups are structure in a way that in the end the ultimate owner of the entire structure is a sole subject (as it is going to be exposed later, usually the "head" of the chain is one ruling family or a entrepreneur).

A corporate group based on a pyramidal structure can be composed by a different number of firms, varying from few units to tens or, in some cases, hundreds. This model is a structure developed as a cascade where the top there is the controlling unit that usually belongs to a unique subject.

For example Firm A owns 51 percent of Firm B which subsequently owns 25 percent of firm C and D which have majority stakes in firms E, F and G and so on and so forth. This structure allows the owner of firm A to ultimately control several firms with a relatively low 3investment. As Barca and Trento (1997) underline the controlling entrepreneurs gain control by spreading the voting rights of minority shareholders out of a large number of firms and concentrating those of the entrepreneur an the company at the top of the pyramid, this model allows the latter "to obtain control over the greatest possible amount of other people's capital with the smallest possible amount of his own" (Hilferding 1910).

Hence the main risk bore by the minority shareholders of the various companies is to have different interest relatively to the ultimate owner. In fact the final goal of the ultimate shareholder is the entire group's performance, consequently it may differ from the one of the minority shareholders having stakes in firms in lower stages of the pyramid (Barca (1996)).

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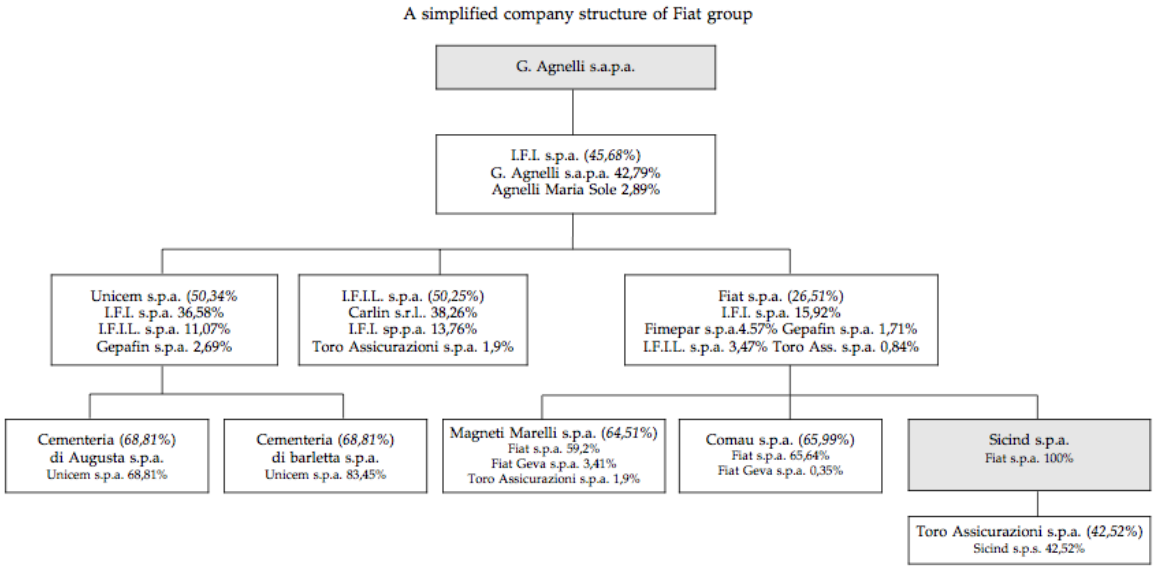
[7] Barca F. 1996, "On Corporate Governance in Italy: Issue, Facts and Agenda" *Worknote 10.96*

[8] Kendall & Sheridan (1992) 68-69

Figure 3.1: A simplified company structure of Fiat Group



Source: Centrale del Bilanci s.r.l. – 30th June 1997
Listed company
Values in italics represent the share owned by companies which belong to the group
The whole structure of the group is composed by 1018 companies
G. Agnelli s.a.p.a. is a partnership

3.2.2.1 Families and Pyramids as the instrument of control

In the modern literature pyramidal groups are usually discussed along with the concept of *family firm*. In fact it appears that in many countries few wealthy families use pyramidal business groups to achieve the ultimate control also of large business groups (Morck and Yeung (2004)).

Family business has always been very developed in all the countries of the world for the small businesses. In fact families run many small business activities as shops, restaurants and many other examples. Although it is more relevant for the studies the application of this pyramidal business system applied to bigger companies.

At this point the main questions are relative to a description of a family firm and why entrepreneurial families rely on pyramids as an instrument of control.

Anderson and Reeb (2003) define a family firm as any firm whose dominant shareholder as is a family. Although other studies like Morck and Yeung (2004) try to evaluate family firm not only by the actual shareholding status but they try to put more emphasis also on the role covered by the dynasty. They thus consider a family a firm a company which is not only

actually owned by a family, but they find fundamental to include in their definition the fact that there is a will of passing the control within the familiar boundaries, hence starting a "dynasty". They hence define a family company any company actually run by heirs or stating clearly that there is an intention of passing the business to the heirs of the actual dominant family.

Although they recognize that this definition might appear too narrow (Morck and Yeung (2004)) they attempt to exclude from their definition cases as the one of Andrew Carnegie[9].

Although the Carnegie's example might be appreciable, in most of the other countries choices like this rarely happen. Once established control over a pyramidal group wealthy families are used to give birth to a dynasty of heirs, which can last for decades.

Considering for example two of the most important Italian industrial groups Italcementi Group and FIAT this transmission of power within the family members is perfectly clear.

Carlo I Pesenti founded Italcementi group in 1865 and Giovanni I Agnelli founded FIAT some decades later in 1899. Until these days the property of the two companies did not change and the same families of the founder are the ones that still run the two companies.

Giampiero Pesenti a descendant of the founder controls Italcementi and the same is for FIAT, whose president is now John Elkann (son of Margherita Agnelli) one of descendents of Giovanni I Agnelli.

3.2.2.3 Agency Problems deriving from concentrated ownership

Basing on the assumption that if a governance structure like the family one is widely adopted, there have to be a logic reason relying at the base of such a great success. The old literature pointed that establishing a pyramidal structure in a company, family ownership was a useful way in order to mitigate the problem arising from the separation of ownership and control in widely held firms (Jensen & Meckling (1976), Berle & Means (1932), Sheifler and Vishny (1997).

Although this vision was logically coherent with their argumentations it did not include the issues characterizing this governance model.

The best cases in order to analyze the agency problems brought by an over-concentrated ownership are, without any doubts, the above described pyramidal groups. Being owned mostly by a family or a sole major shareholder trough a very complex chain of shareholding,

[9] Andrew Carnegie was the multimillionaire founder of Carnegie Steel group who at the end of his life sold the company for 480 million dollars and gave them to charity.

pyramidal groups are the structures that better show the agency problems involved when the concentration of the control in the hands of a unique shareholder may end in an expropriation of the minority ones.
There are three main agency problems arising from the ownership concentration in pyramidal groups: *entrenched management, other people's money* and *tunneling*.

In the case of *entrenched management* the risk relies on the fact that, above a certain level of ownership, families acting as a blockholder may reach a point of entrenchment where owner-managers may expropriate wealth from the minority shareholders. In fact as much as the owner increases his stake in the firm, he has to bear more risk due to the increased exposition and investment. This risk profile can lead to undertake decision aiming to reduce this risk, but also decreasing the potential creation of value for the minority shareholders (Thomsen et al (2005)).

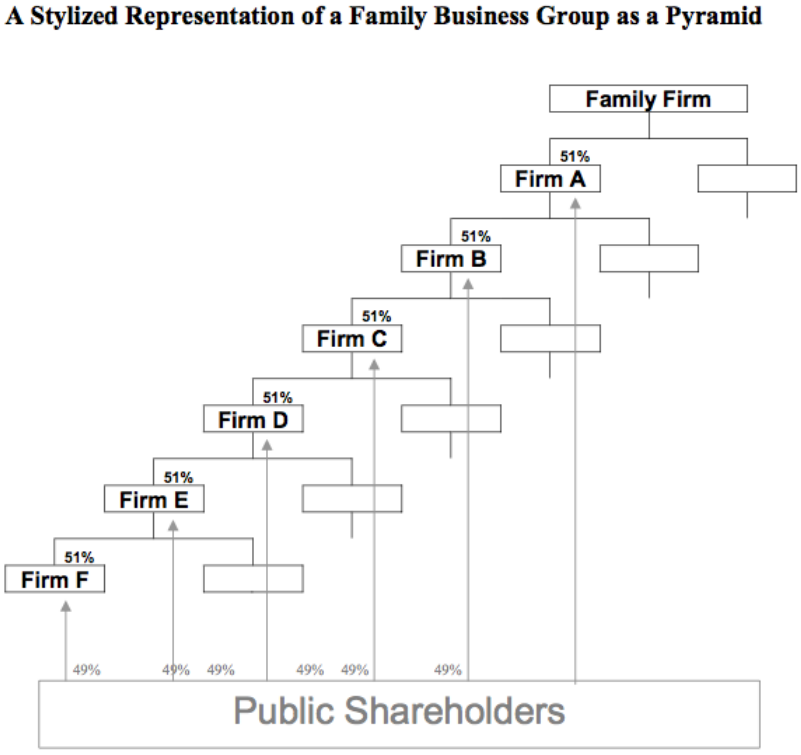
Secondly, *other people money's* regards the risk exposure especially bore by the minority shareholders of the companies standing at the "base" of the pyramidal group. Considering for example family X owning a stake of 51% in Firm A (see the end of the paragraph for Figure 3.2) which subsequently owns 51% of firm B. At this point family X has a total exposure of 25% towards firm B. Following the ladder, if company B has a stake of 51% in company C, the total exposure of family X towards company C (which by the chain of ownership is still owned by family X trough the majority of votes) is 12,5%.
Hence Family X suffers only the 12,5% of any losses of company C although having the ultimate control of it. As further as we go down in the different levels of the business group the exposure towards the losses of the controlling family is more and more limited although keeping the control.
Hence family X can be considered as more and more indifferent regarding the losses occurring by going downwards in the pyramidal structure. In this case they may also decide to deliberately undertake actions that may cause losses in the lowest part of the pyramidal group because they can obtain a positive outcome for the top firms. In this case it is very reasonable that a conflict of interest between the minority shareholders appears. Considering for examples minority shareholders of firm C of the previous example: they will have to bear a total loss of their entire investment (thus 100%) while the family X will have to bear only the 12,5% of those losses.

Consequently minority shareholders of companies at lower pyramidal levels may incur both in the entrenched management issue and other people's money.

Finally insiders may expropriate the other investors by implementing *tunneling* (or *self-dealing*) operation.

In business groups composed by a various number of firms it usually happens that the different firms obtain good, services or financing within the boundaries of the group. In case this happens in combination with artificial prices, the head of the company is able to transfer profits between buyer and seller firm (of the group). In case of artificially high prices the insiders can transfer money from the buyer to the seller firm. On the contrary if the purchase price is artificially low the group can transfer profits from the seller to the buyer. Considering once again the previous example of the group run by family X, they receive only the 12,5% of the profits from firm C but 51% from firm A. hence they will be tempted to transfer profits from the bottom of the pyramid to the top, in order to benefit from the higher stakes owned. Obviously this clash with the interest of the minority shareholders of the firms at the bottom, which end up in being expropriated from the wealth of the companies they invested in.

Figure 3.2: A Stylized Representation of a Family Business Group as a Pyramid



3.2.3 Corporate Governance and Family Pyramidal Groups in Italy

3.2.3.1 Data on Ownership Concentration in Italy

A study provided by Mancinelli and Ozakan (2006) highlight how the level of ownership concentration for Italian firms in 2000 was extremely high: in the 60% of the companies listed on the Milan Stock Exchange, a sole shareholder had the absolute majority; the 80% of over 2000 companies had controlling shareholder. On average the largest shareholder had voting rights of 44%. They also highlight how the voting rights percentages appear to be stable over time highlighting no significant changes during the decade.

Moreover it appears that Italian capitalism is affected by a high degree of ownership and control separation underlined by the amount of capital controlled per unit of capital owned was 2.4 for listed companies and, 4.5 for private non-banking groups and 1.6 for State-controlled companies (Mancinelli and Ozakan (2006)). In this system pyramids are the main source of separation between ownership and control trough the use of circular and cross-shareholdings (Bianchi et all (1998)). In fact 50% of the Italian industrial companies belong to pyramidal groups.

Meanwhile the implementation of the *dual-class shares* as an instrument of deviation from one share one vote did not seem to be a common way to separate ownership and control. In fact respectively only the 1.3% of the *preferred shares* (limited voting rights) and the 7.1% of the *saving shares* (non-voting shares) represented the market capitalization.

In their study they also highlighted that the second largest shareholder is usually a financial institution or institutional investors (on average their quote in listed companies is 8%). Although being on average the second largest shareholder they did not have an active position, until recently. The reasons of this passivity rely on the lack of pension funds and the interlocking and complex relationship bank-owned mutual funds and the listed companies, which may have very stable and deep-rooted relationship with the banks owning the mutual funds.

Some improvements in this leaking structure have been brought by the *Consolidated Act of Finance (*also known with the denomination "*Draghi Reform"* from the name of the Treasury Minister of that time Mario Draghi). This Act provided an important legal improvement under the minority investors protection. However these new legal implementations (although seeming adequate to mitigate the problem) have been a rarely used instrument by the minority

shareholders due to the extremely low and expensive judicial processes. In fact La Porta's (1997) report containing the "efficiency of judicial system" index (i.e. an index evaluating the condition of the judicial system of a country) ranked Italy at the lowest spot among the G7 countries. The result was once more confirmed by the "corruption" index, which saw once again Italy at the lowest spot among the G7 countries.

These data thus confirm once more the commonly accepted theory (see Bianco and Casavola (1999), Barca (1996)), that pyramidal structures tend to appear in countries characterized by a low level of investor protection, thus allowing the ownership concentration in the hands few subjects.

Furthermore it appears that in the 15% of the Italian listed companies, minority shareholders supported the controlling shareholder with coalitions of *voting syndicates* (Volpin 2002). Voting syndicates are coalitions of shareholders deciding as a group reaching a common decision by majority votes or unanimous decision within the subjects composing the syndicate. Italian law regulates these agreements and they have to be notified to the Italian Security Exchange Commission (CONSOB) within five days and they have to be published in the press. Subsequently those agreements have to be deployed in the company register held in the Chamber of Commerce in order to make them available for public consultation. The presence of these voting syndicates provides a further deterrent for the minority expropriation. In fact in when an important decision has to be made (as M&A operations, capital restructuring, change in the foundation act of the company, etc.) minority shareholders voting syndicates may count for fundamental votes thus avoiding to be fully expropriated by the majority shareholders.

Previous studies (Barca (1996)) confirmed this trend showing how the lack of specific regulations provided a strong stimulus for Italian capitalism to orient in the pyramidal structure direction.

In his sample Barca (1996) showed that almost all the considered large industrial companies were part of a group. 60 to 85 percent of the companies with more than 100 employees were part of a group. The percentage decreased to 35 for small companies (i.e. companies with 50 to 100 employees).

He also noticed that there is a strong correlation between size of the firm an its structure. In fact as bigger as the company was, the more probable it was the adoption of the pyramidal structure as a governance system. In particular this relation was evident for groups embedding a listed company.

In summary, the lack of an efficient institutional framework providing a stimulus to facilitate a more dispersed ownership as in the Anglo-Saxon system, an inefficient monitoring by financial institutions, and an insufficient market discipline stimulated the creation of pyramidal groups characterized by a high degree of ownership concentration mostly held by few subjects. The most dangerous outcome of this corporate governance structure is thus the ability of large shareholders, acting as blockholders, to expropriate the minority ones.

3.3 Board Structure and Corporate Governance Reforms in Italy

3.3.1 The Board Structure in Italian Companies

Differently from other countries in the world where the boards usually adopt or the *one-tier system* as in Anglo-Saxon countries, or *two-tier system* as in the other civil law countries like Germany, Italy adopts a different model recalling the two-tier board structure, but including substantial differences (See Appendix 1, Figure 1.1).

Until 2003 the dualistic horizontal system (which is usually referred ad the *traditional* model) was the only possible system that Italian joint stock companies could adopt (Astori et all (2009)). The system is based on the distinction between the managing unit, the board of directors, which could be a sole administrator, or a board (*Consiglio di Amministrazione)* and a board of statutory auditors (*Collegio Sindacale*), which have controlling tasks. Both of the boards are appointed in the shareholders' assembly.

The board of directors has the task of directing and managing the company in order to pursue strategic, industrial and financial aims necessary for the development of the corporation. These actions have always to be undertaken respecting the company's purpose and with the aim of maximizing the value for the entire *stakeholders* population.

Meanwhile the Board of Auditors or *Collegio Sindacale* has to supervise the operations of the board of directors, ensuring that laws and by-laws are observed. Therefore it has to monitor if the principles of good practice, the adequacy and functions of the methods adopted as well as accounting and administration are respected.

Both executives and non-executives directors are proposed by the chairman or by the blockholder of the company. Their election is then remitted to the shareholders assembly, which most of the times is controlled by the majority shareholder (Melis (2000)). The duration of their charge as directors is usually pre-determined by the company's statute and normally it last for 3 years.

Non-executive directors have to role of supervising the executive directors and support them both for the formulation and for the implementation of the strategic decisions and plans. Furthermore they are also called to set the CEO's remuneration.

Executive directors are usually selected by the blockholder of the company. They are usually selected on the basis of interlocking directorates within the other firms of the pyramidal group (this is a common practice especially in listed companies) in order to substitute or integrate the blockholder's will to maintain the control over all the firms of the group.

Regarding the fundamental distinction to ensure board independency between CEO's task and chairman's ones in Italy this distinction seems to be respected although other problems prevent senior management to be considered as independent.

Firstly the division of roles between Chairman and CEO is not sufficiently distinct. Secondly the pressure exercised by the ultimate owner on the management is so strong that usually the board of directors simply ratifies the decisions taken by the blockholder (Melis (2000). Furthermore non-executive directors find very difficult to verify the information provided by the executive directors because even if they have the means to verify the reliability of the information trough accessing the sources of information, this usually can be considered as an act against the implicit rules within the board (Molteni 1997).

Organs as the audit committee, remuneration committee and nomination committee are usually absent in the boards of directors. Sometimes an executive committee is present, absorbing most of the key functions of the board of directors, leaving to the rest of the board the task to ratify what decided in the executive committee (Molteni (1997)).

The *Consolidated Act of Finance* (or Draghi Reform) introduced some innovation in the board functioning in order to ensure higher protection for minority shareholders.

The role of the board of statutory auditors was modified ensuring that the board has to be composed at least by three members and one of them has to represent the minority shareholders. In case more than three members compose the board the number of minority shareholders representatives has to be at least two. A minimum of two members of the board can call a shareholders' meeting in case they found it necessary due to a managerial decision.

Draghi reform has mitigated the problem of the potential overlapping tasks between statutory board and external auditors. In fact external auditors are called to monitor the accounting issues meanwhile statutory board now has to fulfill the task of monitoring the executive directors.

Although solving the potentially overlapping problem with the external auditors, Draghi reform created another potential overlap of tasks between statutory board and non-executive

directors. In fact although remaining distant from the strategic issues, statutory board became closer to the concept of the German supervisory board. Under this point of view if might seems a signal that Italian board structure is putting more emphasis on the minority shareholders protection, placing itself between the two mainly governance systems of one–tier and two-tier board system (Melis (2000)).

3.3.2 The Consolidated Act of Finance (Draghi Reform) and the Preda Code

During the 1990s the above-explained Italian Capitalist system of those years strongly required further legal framework in order to provide a further mitigation of the agency problem brought by the presence of majority shareholders. In fact the previous traditional approach privileged the stability of control through large owners as opposed to the protection of the small shareholders (Melis 1999:129). Hence, even if not clearly stated, the focus was to ensure stability by establishing a system based on small and stable "cores".
However at the end of the 1990s decade this system was not fitting anymore in the developing political, economical and financial situation.
Hence different forces started to push towards a new corporate law which had to re-align Italian economy with the new parameters.
Firstly it was recognized a necessity to expand the national stock market in order to provide more transparency both for individual and institutional investors; secondly, in order to stimulate foreign capitals to enter in the country in form of foreign investors it had to be ensured a higher protection for the minority shareholders. Thirdly the new political climate was favorable to produce a new corporate reform. Fourthly the concept of accountability of control and industrial democracy was supported by the existing new cultural climate (Disano Preite 1997).

Given these favorable climate for change the Treasury Minister of that time, Mario Draghi, reformed the corporate law with an Act named "The Consolidated Act of Finance".
Issued in 1998 it included several reforms in order to increase the minority shareholders protection, although not proposing any reform for the board structure.
The aim of the Act was to improve minority shareholder's protection by improving general disclosure. The Act included new regulations on the shareholder agreements, which had to be publicly announced and they could last for more than three years, furthermore in case of a takeover attempt they were not valid. The Bill also introduced new regulations regarding the

takeover bids as for example in case of a bid on the 30% of total capital market it was mandatory to extend the bid also to the remaining shareholders (Belvedere et al 2000).
Even if the Draghi Reform did not include major changes in the board structure, leaving all the decisions to the companies themselves and not imposing a foreign corporate model[10], it introduced the rule regarding the minority shareholders representation on the board. Boards composed by three members had to include at least one minority shareholder representative, and companies with more than three members had to include at last two minority shareholders representatives. With this new introduction the board of auditors became similar to the German supervisory board (*Aufsichtsrat*) (Mellis (2000) and Amatori (2001)).
A further innovation brought by the Draghi reform regarded the *insider trading* which now was strongly regulated and in addition another reform regarding the proxy votes mechanism was introduced.
With the introduction of the Consolidated Act of Finance the Italian Security Exchange Commission (CONSOB, Commissione Nazionale per le Società e la Borsa) gained relevant power and, differently from the past, it started acting as a monitoring and supervising control over the companies, ensuring more transparency and avoiding the occurrence of fraudulent acts as insider trading (Spaventa (1995): 245ff).

After the Draghi reform a further document was issued in order to complete the reforms. At the end 1999 a committee composed by exponents from industrial, banking, insurance and investors and coordinated by Stefano Preda drew up a document named *Codice Preda* (Preda Code) which once more aimed to align Italian financial market to the most advanced ones.
The Code is not configured as a set of mandatory dispositions but instead is a Code of best Practices, which can be spontaneously adopted by the companies.
The aim of this Code is to issue the *best governance practices* that a company should pursue in order to maximize the value for the shareholders. The pursuit of this goal is thus to stimulate in the long term a virtuous cycle in terms of efficiency and integrity that should also contributes to stakeholders wealth (whom interests are already guaranteed in the civil law code) (Sanguinetti and Costanzo (2006)).
The means to achieve this goal are: firstly providing further disclosure policies for the investors, by efficiently managing risks deriving from the conflict of interests between

[10] With this decision the Italian legislator left the decision regarding which model should be adopted to the firms themselves, which had to decide the board governance model fitting best in their environment (Sanguinetti and Costanzo (2006)).

ownership and control, majority and minority shareholders. Secondly it aims to provide a more convenient instrument for listed companies to efficiently rely on the capital market.

Developed n 13 articles, it mainly focuses on the ethic governing: the board of directors, the internal audit committee, the remuneration committee, the relations with third parties, the relations among shareholders, the shareholders meeting, the board of auditors and on the non-executives directors.

As explained before the aim of the Code is to develop a set of guidelines in order to improve the best practices of all these important elements of the company.

The Preda code was afterwards subjected to various adjustments over time in order to keep it updated with the market trends. During the years from 2001 and 2005 the Preda Code has been subjected to several updates and modifications but leaving unchanged its original structure and goals.

CHAPTER 4: OWNERSHIP IMPACT ON FIRM VALUE AND PROFITABILITY OF ITALIAN LISTED COMPANIES: THREE SIMPLE MODELS

After explaining all the corporate governance issues affecting a capitalist system mainly based on family ownership and pyramidal structure, we (I) now continue with the empirical analysis of the governance of Italian industrial listed firms.

The objective of this study is thus to test if the theoretical issues highlighted above in section 3 may affect the profitability performance of the companies.

As explained earlier in the text there are mainly two major streams leading the discussion on the effects of blockholders. One party considers the potential benefits of blockholders under the monitoring point of view; meaning that larger shareholders are more prone to monitor management's actions because of their strong incentives of ensuring a value maximization for their investment (Jensen & Meckling (1976); Zeckhouser and Pound (1990)).

The other stream set as the base of their argumentations the risk that above a certain level blockholders will gain the benefit of control and they might use that power to expropriate the minority shareholders (Mork et all (1987), Fama & Jensen (1983); Morck & Yeung (2002); Bianco & Casavola (1999)).

The studies conducted on the firm value of the companies characterized by the presence of blockholders also highlight the dualism between the two sides. Until now however, there is no convincing evidence on which of the two theories prevail. In fact both positive and negative effects were experienced in the analysis of blockholder effects on firm value.

Maury and Pajuste (2005), for example, reported negative feedbacks when analyzing the ownership structure of the Finnish listed companies during a period of time of six years (1993-2000). One of their main contributions is the finding that a more equal distribution of voting rights enhances the value of the firms. They show that non-largest blockholders may play an important role in corporate governance because they are able to limit the expropriation of minority shareholders by contrasting the majority shareholders power. Hence confirming the first intuition that non-largest blockholders may provide positive outcomes by providing a more strict control over major shareholder's actions.

4.1 Data

This part of the work aims to empirically investigate what is the impact of the ownership structure of Italian firms on their performance. This analysis is conducted in order to evaluate the correlation between the profitability of the firm and firm's ownership concentration. This goal is pursued trough the implementation of different models considering that different owner-related variables may affect the performance of the firm. The final objective is thus to highlight if and how the ownership positively or negatively interacts with the firm value.

4.1.1 Sample Analysis

The analysis is based on a sample of 223 Italian listed companies over a period of time of five years (from 2005 to 2009). The number of considered firms then decreased to 220 (thus there were 1090 observations in total considering the time frame[11]) due to the total lack of financial data regarding three firms, which were then deleted from the dataset because considered totally useless. The choice of listed companies relies on the data availability. In fact, the risk of not obtaining sufficient financial data on not-listed company could have brought to a "*freeze"* situation ending in the impossibility of successfully implement the statistical regression. Furthermore, since that non-listed companies are not subjected to the strict requirements of the listed companies[12] and since their lack of incentive to provide deeper disclosure data in order to obtain cheaper finance trough the stock market, the ownership data could have been much more difficult (or almost impossible) to obtain.

Hence the choice of relying on listed companies is mainly due to the data availability to successfully implement the model.

Financial companies (as banks, mutual funds and insurance companies) were also not included in the model due their different corporate governance structure and different accountability rules. This decision was taken also by observing the work of other researchers as Maury & Pajuste (2005) and Mancinelli & Ozakan (2006).

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11 This number appears lower in the regression due to the lack of data during some years.

12 All the European listed companies mandatory asked to fulfil the IAS (International Accounting Standards) requirements, while Italian non-listed companies are subject to the set of rules of the civil code.

Furthermore since the aim of the work is to test the effect of ownership concentration on the firm value, some restrictions were applied to the shareholders definition. Only the three major shareholders data were collected and the threshold of stake in the firm had to be at least 3%.

The main source ownership and financial data has been the *Bureau Van Djik "Orbis"* database. From this database it was possible to select all the data need for creating the variables, both under the financial point of view and form the ownership one.

The selected data have been subsequently inserted in a dataset created "ex-novo" for the purpose and sorted by the operational revenue/turnover of the companies.

The data inserted in the dataset are:

- *Company identification:* *id* (i.e. a progressive number given to all the companies for 1 to 220), *Company name* (i.e. the name of the examined company), *Country ISO Code (*i.e. a two letter code identifying the country of the company[13]), *Company Accounting template, SIC4 and SIC2* (i.e. the US SIC classification for the industry), *year,*
- *Financial Information:* *Operating revenue/turnover, employees, fixed assets, total assets, shareholders funds, shareholders funds capital, non-current liabilities, non-current long-term liabilities, current liabilities, EBIT, net income, sales, ROSF (return on shareholders funds), ROA, EBITDA margin, gross profit, Market Capitalization and outstanding shares*.
- *Ownership Information:* these data were collected for all the three major shareholders. *Shareholder's Name, Shareholders' country ISO code, Shareholders' accounting template, direct ownership %, total ownership %*. Owners are sorted by percentage of share stake in the company in decrement order from the one owning the major stake to the third.
- *Global Ultimate Owner:* when the Orbis database was able to trace the Global Ultimate Owner of the firm his/her/its name, Country ISO code and accounting template have been inserted in the dataset. The applied threshold to characterize a Global Ultimate Owner was the possession of at least 25% of the shares of the company or group belonging to him.

[13] Given the fact that the analysis is conducted on Italian listed companies the country ISO code of the company is always IT standing for Italy but it varies for the shareholders.

In order to make the data available for the regression to all the 13 accounting templates was assigned a number from 1 to 13 in the subsequent order: 1 to industrial companies, 2 to companies owned by a one or more named individual families or persons, 3 to financial companies, 4 to mutual pension funds/Nominee/ trustee, 5 to State-Owned enterprises, 6 to Banks, 7 to Private equity firms, 8 to self ownership, 9 to Publicly listed companies, 10 to Insurance companies, 11 Foundation and research institutes, 12 to Venture capital firms and 13 to other unnamed shareholders.

The final remark on the sample description regards the fact that not all the data included in the dataset have been used in the final regressions. In fact the main goal of the dataset was to include as much information as possible, in order to be able to create all the possible combinations for the definition of the (considered) more useful variables to test the objective of the regression.

4.1.2 Variables Description

Since the aim of this part of the work is to test the effects of ownership on the performance of the firm, the three main dependent variables are three widely recognized performance variables.

Dependent Variables: The main dependent variables aiming to capture the value of the firm is *Tobin's Q* index. Tobin Q index (as it is defined in the Maury & Pajuste (2005) work which is the adopted benchmark for this index) is defined by market value of total assets divided by the total cost of asset. It has been calculated by summing the market value of total assets and book value of total assets minus the book value of the shareholders' founds all divided by the book value of total assets. The importance of Tobin's Q as a firm value proxy is highlighted by its adoption as the main dependent variable for the regression in some relevant papers analyzing this issue (Maury & Pajuste (2005); Thomsen (2005), Thomsen et al (2006)[14]). All the data necessary to compound the Tobin's Q index were extracted for the dataset. Hence hey entirely come from the *Bureau Van Dijk "Orbis"* database.

[14] In both of the Thomsen works it is defined as "Q" because it is an approximation of Tobin's Q due to the unavailability of the equity at replacement costs (S. Thomsen et al (2006):257)

The second dependent variable, adopted as a firm value/profitability index, is the *ROA (Return on Assets)* ratio. The ratio was directly provided, without being computed, by the Orbis database.

The third performance evaluation ratio is the *profit margin*. Profit margin is computed as the *net income* divided by the *sales*.

The relevancy of this ratio regarding the performance of the firm, and hence its reliability, is related to the fact that a high profit margin means that a company is able to generate profits but at the same time it also has the necessary capabilities to control its costs.

However it has to be stated that both the last two dependent variables are considered as complementary to the main dependent variable which is going to be Tobin's Q. In fact both ROA and profit margin might be influenced by industry and sizes of the firms. Hence, if a sole firm comparison is conducted on the basis of these two ratios, the results might be influenced by the above-mentioned factors. For these reasons, although still considering these two performance measures as very important and relevant proxies for firm value and performance, the main dependent variable will be Tobin's Q.

Control Variables: the selection of the control variables was conducted by the observation of the work of the main researches of the field. In total four main control variables were chosen. The reason of their choice was related to the fact that in previous studies (as Maury and Pajuste (2005)) they appeared to have an impact on Tobin's Q index.

The control variables included *firm size, asset tangibility* and *financial leverage*.

Firm size variable is calculated as the logarithm of total assets and its coefficient is expected to have a negative sign as much as the companies' size increases. This means that the increase of assets in a large firm at a maturity stage of its life cycle will negatively influence the value of the firm.

Leverage is calculated as the non-current long-term liabilities divided by the total assets of the firm. At this point it is impossible to formulate expectations on the possible effect of debt on firm value. On the one side debt financing benefits from the tax shield effect, and it may also provide a further incentive for the management to implement efficient projects and not waste money, in order to avoid the risk of ending in financial distress (Briley, Mayers and Allen (2008). Based on this, the impact of firm debt on firm value should be positive. However too much debt might lead to an unbalanced equilibrium in the debt/equity ratio, which can end in financial distress situation, directly leading to huge costs that the company has to bear. In case of the occurrence of this scenario, the coefficient of the leverage variable in the regression is

expected to have a negative sign, meaning that an increase in the debt level of the company will lead to reduction in the value/profitability of the firm.

Tangible assets are calculated as the ratio of fixed assets divided by the total assets. The relevancy of this variables is related to the fact that companies with a low tangible assets ratio generates most of their cash flows trough intangible assets as for example human capital. Hence in this case it is expected that the value of the firm will be negatively influenced by the tangible assets variable.

We label the main explanatory variables- the variables whose effect is of our interest in the analysis, as independent variables. The selected independent variables cover three aspects, which are considered to be relevant for the studies.

Independent Variables: The first set of independent variables includes the direct percentage of the stake of the three major owners in the company: we label these variables as *shrdir1, shrdir2* and *shrdir3*.

However it has to be stated that in some specific cases ultimate ownership has been used at the place of direct ownership[15]. This is due to the fact that most of the companies had data available only on one type of ownership, mostly direct ownership, but some companies only provide information for ultimate ownership. Hence the main problem was for some shareholders we had only the direct and for some others only the total ownership percentage. Thus, in cases where there was no information for direct ownership, the total (ultimate) ownership was taken instead. The second set of independent variables is taken from the Maury and Pajuste (2005) paper and their main objective is to highlight the contestability power of the largest shareholders of the firm. The first variable of this set is the Herfindhal index (*shrdifference2*) computed by the squared difference of the stakes of the first and second shareholder, and summed with the squared difference between the second and the third shareholder stakes, $(shrdir1-shrdir2)^2 + (shrdir2-shrdir3)^2$. The second Herfindahl measure is a proxy of the concentration power of the three shareholders and it is calculated as the squared sum of the ownership percentage, (shrdir1+shrdir2+shrdir3)^2. Both these two variables are expected to have a negative effect on the value of the firm by assuming a positive correlation with the value of the firm (or its profitability) and the capabilities of the

[15] When the data on the direct ownership was not available the ultimate ownership was selected as the best proxy. Differently from the direct ownership the ultimate ownership takes into consideration the total ownership of the shareholder. Hence to compute the ultimate ownership both the direct and also the indirect ownership (meaning the stake percentage owned trough controlled firms) are taken into account.

other major shareholders to contrast the first largest owner and mitigate the agency problems between minority and majority shareholders.

The third and last model aims to evaluate the impact on the firm of the first shareholder type, this model thus attempts to answer the following question: What happens if the first shareholder is an industrial or financial (etc.) firm?

In order to study this, different variables were created aiming to indentify the type of the shareholder owning the majority of the stocks. The analysis was conducted on the four main shareholders types: Industrial firms, Family firms, State-owned firms and Industrial firms.

To compute the variables, the ownership percentage of the first shareholder (*shrdir1)* and the first shareholder type (*firstshrtypeX,* where X is the number standing for the above explained re-definition of the accounting templates of the shareholders) were combined into interaction terms[16]. Four for variables were created: *indusrialfirst* for the industrial type, *familyfirst* for companies owed by a family or a subject, *statefirst* for the state-owned companies and *financialfirst* for the companies having as the first shareholder a financial company.

The regression of these independent variables on the three dependent variables is expected to show if or how the value of the firm or its performance is affected by the fact that the first shareholder is one of the above-explained types. In other words, we look whether the impact of ownership concentration is different when the major owner is an industrial firm than, for example, some other owner.

We can form no strong initial expectation on the effect of industrial firms or family ownership on firm value. There are reasons for which we could expect this impact to be positive but also negative. On the other hand, state ownership is always expected to have a negative relation on the firm value both as the first shareholder and also by increasing its stake in the firm. In fact, the Italian firms have a long history of political involvement in the firm governance with negative consequence on firm ability to perform.

Financial firms' effects are, as well as industry and family, difficult to predict. However on one side it is possible to predict good results, on the other side it is also possible to predict bad results; in fact by analyzing the dataset it is possible to notice how some of these companies reports similar or the same name or of the owner or of the industrial company, standing as the second shareholders. It is thus a solid hypothesis considering some of these companies only a

[16] In order to compute this variable the dummy for the nature of the shareholder was multiplied with the interaction term (shrdir). The obtained results was a variable, which regressed on the dependent variables had to show the impact of the nature of the shareholder. The names of the variables derive from the dummy of the shareholder's type: for example "familyfirst" was the combination of the dummy of the "one or more named individuals" type and the shares of the first shareholder.

mere instrument of control of the largest shareholder. Hence in this case it might be very difficult to provide a strong prediction on which the outcome will be.

Dummy variables: apart for the dummies for the identity of the main owner, additional dummy variables have been included in all the regression. The first are the dummy variables for time (*yeardummyX*) accounting for time effects and the second one are the dummy accounting for the industrial sector of the firm *(twosectorX)*. The second dummy has been calculated by on the data obtained trough the SIC2 code classification.

4.1.3 Descriptive Statistics

Before implementing the regressions an analysis on the descriptive statistics of the variables will provide the first relevant information highlighting some theories explained before in the text.
The first table shows the descriptive statistics of the three dependent variables:

Table1: Descriptive statistics of the three dependent variables over the 5 years timeframe

variable	min	max	p50	mean	sd	N
TOBINq	.1251	7,7539	1,2645	1,4227	.7121	851
roa	-68,53	45,38	4,385	3,4166	11,131	992
profitmargin	-287,1818	7,6395	0,335	-0,3994	9,403	993

Table 1 presents the summary of the descriptive statistics of the three dependent variables. TobinQ has a mean of 1,42 and ROA has a mean of 3,41. However the most surprising result is the negative sign of the profit margin's mean (-0,335). Several reasons might rely as an explanation of this negative sign as for example the production incapacity of keeping the costs under control. However another remark relies also on the selected timeframe. In fact during the period of time selected for the analysis a massive financial crisis occurred hitting the consumption demand. For this reason it can also be made an assumption regarding the fact that the ongoing global crisis might have influenced the data and consequently the variables outcome. Thus also this element has to be taken into consideration while commenting the negative sign of the profit margin's mean.

Previously in the text it was explained the characteristics of the Italian Capitalism, characterized by a high degree of ownership concentration. The results showed in Table 2 provide a further remark on these evaluations by presenting the descriptive statistics of the ownership concentration variables (*shrdir1*, *shrdir2* and *shrdir3)*.

Table 2. Descriptive statistics on the ownership concentration

variable	min	max	p50	mean	sd	N
shrdir1	.17	100	50,1	44,47951	23,94	975
shrdir2	.16	96,7	17,09	26,7289	21,9768	854
shrdir3	.02	88,49	7,41	11,80,96	12,58,57	741

As shown by the results of the descriptive statistics, the mean of the stake in the firm of the first three shareholders is major then 10. In particular, as expected the mean of the first shareholders' ownership percentage is significantly higher than the others (44,47 percent). However also the mean percentage of the second and third largest shareholder's is considerably high (respectively 26,72 and 11,8 percent). Hence the above-cited studies on the ownership concentration characteristics of the Italian capitalism provided by the researchers are strongly confirmed also on this brief analysis.

Furthermore, although being very a very simplistic analysis, examining the number of observations N it is noticed a decrease. In particular: the highest frequency is noticed in the number of the observations regarding the first shareholder, then the number decreases for the second and even more for the third. A basic analysis of this examination suggests that in some Italian listed firms the presence of the second and, especially, the third shareholder (with an ownership stake higher than 3%) is not always present (or verifiable). The weakness of this elementary analysis although relies on the fact that it might occur that the difference in the number of the observation is brought by the lack of data in the initial source of data, the Orbis database.

A further remark of the high degree of ownership concentration characterizing the Italian Capitalist system is provided by Table 3, which shows how many firms of the sample are characterized by an ownership degree higher or equal to the 50%. From the data of the sample

it has been possible to show that during a period of five years 494 observations out of 971, meaning the 50,88 percent of the firms of the sample are characterized by a majority shareholder owning 50% or more of the company. This is a further confirmation of the fact that, differently for common law countries, in Italy the mostly adopted system involves the presence of an ultimate owner having the control power of the company.

Moreover considering the previous description of the Italian Capitalistic system and combined with the theory explained above in the text about the pyramidal system. These numbers confirms that the half of the Italian industrial listed companies have an owner controlling the at least 50% of the group. Thus, although in an indirect form (in fact no pyramidal groups analysis was provided), the combination of this information and the theory provided by the researchers confirms the fact that Italian corporate structure is mainly based on a highly concentrated ownership.

Table 3: Shareholder presence owning 50 percent of more of the shares

majority*	Freq.	Percent	Cum.
0	477	49,12	49,12
1	494	50,88	100
Tot.	971	100	

**majority variable has been created by giving a value of 1 if the value of shrdir1 was major of equal to 50 and 0 in case it was minor. Subsequently it was asked to calculate frequency and percentage of the values.*

The last descriptive statistics Table aims to analyze the accounting template of the first shareholder. Specifically it was calculated the frequency and percentage of the various types of firms whenever they were the first shareholder.

Table 4: Frequency and percentage of first shareholder's nature

	Freq.	Percent
firstshtype1	383	39,2
firstshtype2	276	28,25
firstshtype3	170	17,4
firstshtype4	23	2,35
firstshtype5	39	3,99
firstshtype6	38	3,89

firstshtype7	19	1,94
firstshtype8	6	0,61
firstshtype9	14	1,43
firstshtype10	5	0,51
firstshtype11	3	0,31
firstshtype12	1	0,1
tot	977	99,98

Firstshtype1=industrial company; 2=one or more named individual or families; 3= financial company; 4=Mutual & Pension Fund/Nominee/Trust/Trustee; 5=Public authority, State, Government; 6=Bank; 7= Private Equity companies; 8= Self Ownership; 9=Public (Publicly listed companies); 10=Insurance company; 11= Foundation/ Research Institute; 12=Venture Capital

As expected, industrial companies and families are the most common major shareholder type. This provides a further proof of the previous analyses conducted on Italian Capitalism. Families and groups are the most common category as major shareholder with respectively the 28,25% and the39,20% of the observations: thus it is possible to state that pyramidal groups and family business, also in listed companies, are still nowadays the most common way to organize the governance of the companies.

A further remark has to be made by the percentage of listed companies having the State as the ultimate controller. In fact the obtained data shows that differently from the previous 1990s era, where State's presence as major shareholder was heavy and diffused, the privatization policy adopted by the beginning of the 1990s led to a slight decrease of the State-Owned enterprises among listed companies. In fact only the 3,99% of the sample's observations are companies run by the State as the major shareholder.

Being the first shareholder only in the 2,35% of the observations, banks cannot be considered as a usual majority shareholder of the Italian listed firms. This brings the discussion on the comparison between Italian and the of the main corporate governance systems of Continental Europe: the German system. In fact the fact that only few banks are the major shareholders of industrial companies highlights how differently Italian and German market developed during the years. In fact while in Germany banking system is still enforce and the main bank is the centre of the business groups, in Italy banks are still mainly a source of finance in forms of loans, but not with equity. Hence it appears that although the 1936 law prohibiting banks to have equity stakes in industrial firms has been modified, banks reluctantly undertake operations aiming to purchase significant equity stakes allowing them to control the firm.

The last comment has to be made on financial firms as the first shareholder (17,4%). As explained before in the text, these companies are mainly holdings located abroad which has to role of controlling the firm for the final owner of the company, which is usually a family or an individual.
As expected the other considered categories do not have a significant percentage of ownership allowing providing relevant comments.

4.2 Methodology

The methodology adopted for the regressions is mainly based on the use Simple Panel Data's Pooled OLS and Advanced Panel Data regression with Fixed and Random Effects analysis.
The first option, the Pooled OLS, is the simplest. The main force of the Pooled OLS model relies on its simplicity (and its BLUE[17] characteristics), however it suffers from some drawbacks, which may result in biased and inconsistent coefficients of the regressors due to impossibility to account for unobserved firm heterogeneity.
Hence if the error terms are correlated with the regressors (thus leading to a heteroscedaticity problem) the obtained coefficients of the regression results to be biased and inconsistent.
In order to provide a further and more consistent analysis, it is thus implemented the Advanced Panel Data regression considering Fixed effects and Random effects. Random Effects (RE) and Fixed Effects (FE) have the main advantage of taking into consideration both time and cross sectional components. Moreover, the FE also allows us to account for time invariant unobserved firm heterogeneity. The choice between FE and RE for the regression is dictated by implementing the Hausman test and analyzing the p.value obtained. If the obtained p-value in minor than the threshold of 0,05 the Hausman test suggest to implement the regression with the Fixed Effects, while if the p-value is major than the specified value of 0,05 the Random Effects are implemented.
In order to test the presence of multicollinearity in the model the Variance Inflacion Factor (VIF) is implemented and it shows that the model may suffer from problems of multicollinearity. However the problem does not appear to be too severe. In fact considering as the threshold value for multicollinearity problem existence the value of 10, the results of

[17] BLUE: Best Linear Unbiased Estimator. Meaning that the Beta estimator of the model has the lowest variance (and thus the best precision) among the linear and not distorted Beta estimators.

the *VIF* analysis does not goes too much further, staying approximately at the indicated level. Furthermore by looking at the VIF table (Appendix 4, Table 4.1) it appears clear that only the sector dummy suffers from multicollinearity problems.
Furthermore in order to prevent and remedy the and potential correlation of the error term within the same firm across years, we use of cluster robust standard errors, which solve the above-mentioned problem.

For the analysis both Simple Panel Data and Random and Fixed Effects will be implemented on all the regressions on the three dependent variables.
For each of three sets of independent variables (shareholder's stake in the firm, contestability and nature of the first owner) it will be implemented both the two regression methods. The same procedure will also be applied for all the three dependent variables (TobinQ, Roa and Profit Margin).

4.3 Analysis & Discussion

4.3.1 Impact of the shareholder concentration on the performance variables

As the Table 2.1 (Appendix 2) shows the variables selected as a proxy of the three major shareholders concentrations do not appear to have a significant impact on the dependent variable Tobin's Q with the exception of *shrdir1* (i.e. the percentage of ownership of the first shareholder) which, in the pooled OLS regression model, is almost significant being minor than the p-value of 0.25. Differently from what expected it has a positive coefficient of 0.02 which in absolute terms has a very light impact on the value of Tobin's Q (which has an average of 1.42), meaning that a one point change in the variable will positively affect the Tobin's Q by 0,02. However it has to be considered also the fact that a change on the base of ten points in the first ownership stake will increment the Tobin's Q value of 0.2 points, which is a relevant impact on Tobin's Q given its average of 1.42.
The positive effect of the *shrdir1* coefficient has a further proof observing the regression results on the second dependent variable *ROA*. In this case both the coefficients for pooled OLS and for the Advanced Panel Data's Fixed and Random Effects are significant at the 95% confidence level (p-value<0.05) and a positive sign of the coefficient characterizes both of them. For pooled OLS the coefficient for *shrdir1* is 0.068 while in the Panel Data regression with fixed effects (the p-value of Hausman test is 0.0000 and thus the null hypothesis of

stochastic effects not correlated with the regressors is rejected, leading to the use of fixed effects) the coefficient is 0.3891. Hence the *ROA* regression not only confirms the result obtained in the Tobin's Q pooled OLS one but it provides also a stronger outcome. In fact the coefficient are much higher implicating that an increase of the first shareholder stake in the firm will lead to an increase on the value of the return on assets.

These results are quite surprising because in reality it was expected a decrease in the profitability/firm value as higher as the stake of the first shareholder increases due to the agency problems brought by the ownership concentration.

However there are several possible explanations of the positive sign of the coefficients. Firstly the firm may benefit from having a controlling shareholder on several aspects. Meaning that owning a large stake in the firm the controlling shareholder has the interest on running the company in a way that it will increase its value because an increase in the value of the firm will directly lead to an increase of its personal value.

Secondly it also can be assumed that having a controlling shareholder may bring benefits also from the long-term planning point of view (Morck & Yeung (2004)). In fact differently form management in widely held companies, a majority shareholder can implement long term plans which benefits will appear in the future because he is not pushed by the universe of small shareholders to provide immediate outcomes and thus short-term planning strategies focused on achieving immediate results for the minority shareholder's satisfaction.

The final remark has to be made about the nature of the considered firms. In fact all the firms considered in the sample are listed in the Italian Stock Exchange and thus they are subjected to the more strict rules about disclosure and accounting that will reduce the negative aspect of having a controlling shareholder by bringing more transparency.

Another aspect showed by the analysis of Table 2.1 (Appendix 2) is that, while in all the other regression on the dependent variables, in *ROA* regression the coefficient of the third shareholder is negative both for OLS and Fixed effects (respectively -0.103 and -0.086). Thus an increase of the stake of the third shareholder will have a negative impact on the return on assets of the firm. From the results it appears that the third shareholder has a negative impact on the profitability proxy selected. This might be the case of having a third shareholder owning enough shares to exercise a blockholder role and undertake internal fights with the other major shareholders leading to a value destruction for the firm due to the costs and time expenditure of the fights.

As expected all the other control variables have the expected sign, however a remark on the leverage coefficient's sign in the Tobin's Q regression deserves a deeper observation

As previously anticipated in the text the sign of the coefficient of the leverage control variable would have been difficult to predict due to the double nature of the debt: efficient source of finance and cause of financial distress costs.

In the Tobin's Q fixed effects model it appears that debt has a positive impact on the value of the firm: in fact its coefficient (significant at the 95% confidence level) has a positive sign (0.634). This means that an increase in the debt level will bring benefits for the firm value. The implications of this observation may rely on the fact that shareholders are not so confident in adopting debt as the source of finance because they fear the financial distress and they thus prefer to rely on internal capital. Although avoiding the risk of financial distress they also avoid the benefits brought by debt in form of incentive for the management and in form of financial advantage benefitting from the tax shield (Brealey Meyers and Allen (2008).

The negative sign of the leverage variable's coefficient in the *ROA*'s pooled OLS regression (-8.03, significant at the 90% confidence level) may appear as contradictory compared to the previous explanation; however being not significant on the Panel Data analysis may show that it includes time effects which are not captured by the pooled OLS model. However the negative sign may capture the difficulties in operating for the management in case of an increase of debt due to the higher constraints brought by the adoption of debt.

No considerations can be made for the impact of the companies' second largest shareholder on the profitability/value of the firm. In fact all the regressions shows no significant coefficients for the *shrdir2* variables. Hence no comments can be made on their sign.

4.3.2 Contestability Regression Results

Table 2.2 (Appendix 2) shows the results of the analysis of the contestability's proxies' *shrdifference2* and *shrconcentration1,* which are the two Herfindahl indices selected as the proxies for the contestability of power.

The analysis of the results shows that the two proxies are not significant in the regressions on Tobin's Q as the dependent variable. However the regressor's p-value in the next regression on the profitability proxy ROA rejects the null hypothesis of no-significance three times out of four. In fact among the four regressions (one with Pooled OLS and one with Adv. Panel

Data for each proxy) the only coefficient that appeared not significant is the *shrconcentration1* on Adv. Panel Data.

However differently from what expected but theoretically in line with the findings on the shareholder's concentration regression's results (brought by the regression of the first set of independent variables), the coefficients of the regressions with *ROA* as the dependent variable are positive. *Shrdifference2* (i.e. the contestability proxy for the sum of squares of the differences between first and second ownership stakes, and the second and third largest ownership stakes) has a coefficient of 5.59 at a confidence level of 95% and it is almost significant (p-value < 0,25) in the random effects regression (Hausman results: p-value = 0.4542) with a coefficient of 2.64. If a negative relation would mean that a more equal distribution of voting power among the largest shareholders would bring positive effects for the performance of the firm, a positive relation means the opposite. Consequently analyzing the data shed in the table a more equal distribution would negatively affect the performance of the firm.

The results are in line with the findings of the previous paragraph where the variable for the third largest shareholder ownership stake (*shrdir3*) showed a negative coefficient. The combination of the results on the contestability proxies and the results from the relation of *shrdir3* and *ROA*, provide a further confirmation that an increase of the third shareholder's ownership stake in the firm will be actually value destroying. As explained before the main possible reason relies on the fact that the other shareholders (since we do not have significant results on the second shareholder all the assumptions will be made basing on the third shareholder point of view) will have different goals from the majority shareholder and thus it may arise a conflict of interest. However on average the percentage of ownership in the firm is on average big enough to be considered as a blockholder (as shown in the Table 2 chapter 4.1.3). Hence owning relevant stakes of the company also the third shareholder may implement policies (as opposing to the decisions in the assembly is owning enough voting rights) to avoid the majority shareholder to undertake specific actions. This conflict may thus lead to a destruction of value for the firm due to the costs and loss of time for the dispute.

The results are confirmed also in the regression with profit margin as the dependent variable. The results are almost significant and thus their explanatory power is taken into consideration only relatively. In the Pooled OLS regression the shareholder's difference index has a coefficient of 3.34, while in the regression with random effects (Hausmann p-value = 0.7425 and thus the null hypothesis is accepted) it has a coefficient of 1.57. Although not fully

significant these results provide a further confirmation about the positive sign of the coefficient always keeping into consideration their non-significance.

Furthermore, a confirmation of the positive effects of ownership concentration is showed by the Pooled OLS regression of the contestability proxy of the shareholder concentration, which is characterized by a positive coefficient 2.72 (significant at the 90% confidence level). This result suggests that the concentration is positively related to the performance capabilities of the firm. However the fact that in the Advanced Panel Data regression, the coefficient turned to be not significant has to provide a warning that some time effects may have biased the results of the OLS regression.

4.3.4 The Impact of the first shareholder's nature

The last step in for this regression analysis aims to highlight if there is an evident relationship between the value of the firm or its performance and the nature of its majority shareholder.
The results shown in Appendix 2, Table 2.3 allow pointing several interesting arguments.
The first thing that has to be appointed appearing evident by observing the results of the table, regards the fact that only few results appeared as significant in the analysis. Specifically the majority of the significant results have been observed in the regression with Tobin's Q as the dependent variable while only one result was significant in the regression on *ROA* and zero (with the exception of one coefficient which is almost significant) in the regression on the *profit margin* as the dependent variable.
However some considerations can be made about the results of the regressions.
Firstly, from the Pooled OLS regression on Tobin's Q *familyfirst*'s (i.e. the variable showing the effects of having a family as the majority shareholder) coefficient shows a positive sign (0.05 at a confidence level of 90%). This result implies that for the Pooled OLS regression the fact of having a family as the first shareholder has a small positive impact on the value of the firm. The explanation of this positive coefficient may rely on the positive aspects of having a family as the major shareholder: for example the longer time horizon policies or the aim of maximize the value of the firm in order to increase their personal value as well.
However the coefficient of the second considered variable *firstshrtype2* shows that an increase of the ruling family's stake in the company will negatively affect the value of company. In fact the variable *firstshrtype2* aims to capture the effects of an increase in the stake of the majority shareholder (which belongs to accounting template 2, thus "one or more

named individuals or families). The coefficient of the variable is highly negative: -0.373 (at a confidence level of 99%).

The importance of this finding relies on the fact that it provides a partial confirmation of the theories on the agency problems in the large pyramidal groups run by families. In fact although the positivity of the *familyfirst* variable' sign, its value can be considered as small an next to zero, thus almost irrelevant for the analysis. On the contrary the highly negative sign of the variable measuring the impact of a family's ownership stake increase, shows that a highly concentrated ownership with a family at the top of the pyramid aiming to increase the stake in firm will bring negative implications for the value of the firm. Hence in this case the reason of the negative sign has to be searched in the theories explained above in the text.

Another important result regards the findings on the State as the first shareholder. Although very few companies have the State as the majority shareholder (as showed before in the descriptive statistics part), its presence as the controlling agent has a negative impact of the value of firm. In fact, as expected, in the Panel Data regression with Fixed Effects the variable *statefirst* (i.e. the variable aiming to capture the effect of the State as the majority shareholder) has a negative coefficient (-0.0032) in a confidence interval which is almost significant (p-value < 0.25). However it has always to be remembered that the coefficient's significance only in a wider range does not allow to draw imperative assumption, but alternatively it suggest to be careful with the deductions made on the result.

The same reasoning can be applied to the results concerning the industry category as the majority shareholder. In the Pooled OLS regression the variable *industrialfirst* has a negative coefficient: -0.0028, almost significant. Thus from the data it exists a negative relation between firm value and an industrial firm as the first shareholder. However an increase in the stake of an industrial firm has a positive impact in the value of the firm as showed by the positive coefficient of the variable *firstshrtype1* (0.1683).

This effect is once more remarked in the analysis on the performance variable *ROA* where in the Panel Data analysis with Random effects the coefficient of the variable *firstshrtype1* is positive and very high (2.44 at a confidence level of 95%). It can be thus stated that an increase of the level of ownership of an industrial firm when it is the largest shareholder has a positive effect both on the value and on the performance of the firm.

4.4 Critiques to the model and Conclusion on the statistical regressions

Although providing some interesting results it has to be stated that the above explained model and its regression suffer from several drawbacks, which could not be fixed and ended in affecting the outcomes of the model.

- The dependent variable of the profit margin, selected as a further variable of performance, almost never showed significant coefficients for the regressors variables. Although this is not a proper drawback it shows that a better measure of cost efficiency might be needed.
- Some structural mistakes could have been brought by the initial dataset, in fact while transferring the data to the excel spreadsheet, sometimes it was noticed or a lack of data in specific years or alternatively the impossibility of certain numbers (for example sometimes the direct ownership of some companies exceeded the 100%). However since the number of cases was limited it was to decided to continue with the work although realizing that the final outcome could have been a little bit biased.
- The lack of a formal model led to a misspecification of the variables and thus some of the coefficients of the independent variables ended with a non-significant coefficient, thus making impossible to provide and reasonable and statistically founded comment.

Although affected by the explained problematic the regressions showed some interesting results.

The most unexpected and remarkable one is without any doubt the positive relation between the first shareholder' s ownership percentage and the value of the firm and the in the meantime the negative one with the third largest shareholder. In fact differently from what expected, the regressions showed that an increase of the stake of the first shareholder would have positively affect the value and the performance of the firm, while an expansion of the third largest shareholder would have brought negative consequences. The confirmation of these results came from the concentration proxy, which provided a further proof the findings of the first set of independent variables.

Finally the analysis of the majority shareholder's nature affecting the value of the firm, showed that evidently Italian listed companies would no benefit from an increase in the ownership stake in those firms run by a family. On the contrary, for the companies run by an

industrial firm, its increase in the ownership stake would positively affect the value of the company itself.

CHAPTER 5: CONCLUSIONS AND SUGGESTIONS FOR FUTURE RESEARCH

Do these results provide a powerful evidence that ownership concentration and family control do not create agency problems affecting the firm? The personal answer of the writer is no, but with some needed specifications. In fact the negative relationship of the third largest shareholder (which on average can be treated as a blockholder due to the results of the descriptive statistics) may suggest that an agency problem may be involved. However its nature is different from the ones described in the literature of the previous chapter, when the majority shareholder expropriated wealth from the minority ones. Here the results suggest that as much as the third power of the firm grows as much as it negatively affects the company's value. One hypothetical reason of this negativity may rely on the fact that as higher stakes in the firm the third shareholder owns as much is capable to stop activities of the first shareholder which are not aligned to its interests but the might be valuable for the firm. Hence it is possible to picture a scenario where, although owning the greatest part of the shares, the majority shareholder is kept "captive" by the power in the hands of the third biggest shareholder, which even if does not own the majority of the shares is still able to provide a relevant block.

These results, contrary of what thought before the regression, tend to deny the results of the above citied work of Maury and Pajuste (2005), who discovered that an increase on the level of blockownership of the other minority shareholder would lead to a higher firm value.

Meanwhile the positive impact of a theoretical growth of the first shareholder's stake in the firm suggest that the threshold level of ownership concentration (Thomsen 2008) has not being reached yet an the firm would still benefit from an increase in the ownership concentration with an exception (Thomsen (2008)).

In fact the following regressions showed that an increase in the company's value would be brought only in case that the first shareholder is not a family or an individual. In fact in this case, an increase in the ownership stake would negatively affect the value. In a way this result confirms the theoretical research made above, which pointed how and why a family control will bring agency problems and other strategic issues (as the *creative self destruction*) affecting the performance (and consequently the value) of the company itself.

In conclusion, as the previous analysis pointed out, a deeper analysis on the conflicting relationship between the majority shareholders and the other major blockholders would

provide without any doubt a great added value for the subject. Hence I feel confident to suggest for the future research a deeper analysis on the highlighted topic, especially in countries characterized by a high degree of ownership concentration.

In fact until now a great emphasis has been applied to the research of the possible drawbacks of having an ultimate owner at the top of the group, implying the risk for minority shareholders to see their wealth expropriated for the personal purpose of the majority shareholder. However in the Agency problem of third type (majority versus minority shareholders) it is seldom taken into consideration the possibility for the minority shareholders owning a stake in the firms giving them the status of blockholders, to exercise a pressure on the decisional power of the majority shareholder ending in a value destroying conflict for the firm itself.

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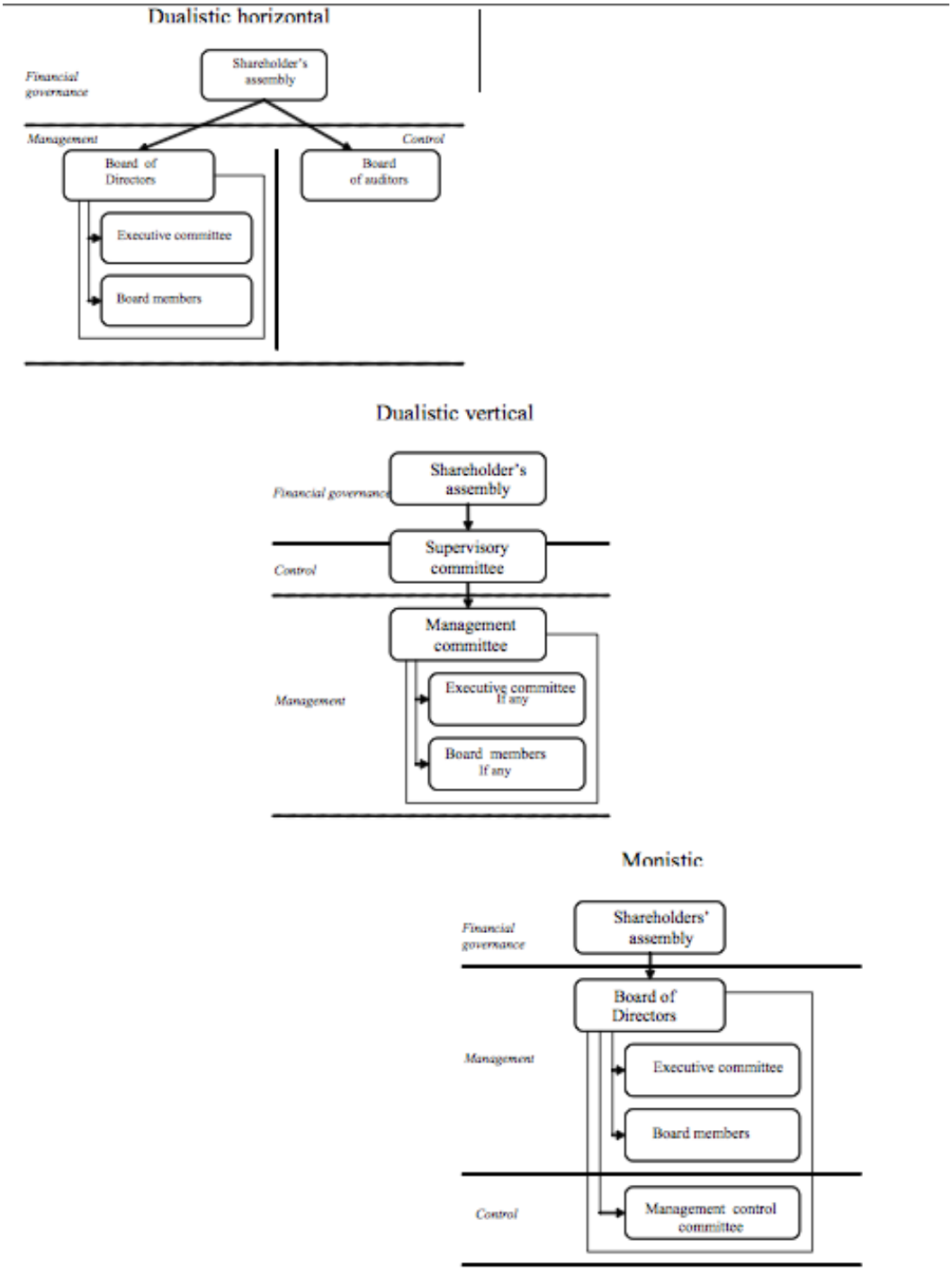
APPENDICIES

APPENDIX 1: Figure 1.1. Three different models of Board Structure



Source: Astori et all. (2009), figure 2 pp. 445

APPENDIX 2: Table 2.1: Regression results of shareholder's concentration variables on the performance variables

variables	**TOBIN Q**		**ROA**		**PM**	
	coefficient		coefficient		coefficient	
	POOLED OLS	PANEL DATA	POOLED OLS	PANEL DATA	POOLED OLS	PANEL DATA
shrdir1	.0022247+ (1.31)	-.0006828 (-0.59)	.0677527** (2.58)	0.389141** (2.28)	.0450631 (1.04)	.022839 (1.05)
shrdir2	-.0005703 (-0.34)	.0004875 (0.24)	.0212577 (0.87)	-.0124725 (-0.6)	.0082385 (0.81)	.0068329 (0.93)
shrdir3	-.0015158 (-.052)	-.0007975 (-0.36)	-.103161** (-1.98)	-.0859406** (-2.32)	-.0173813 (-0.98)	-.004787 (1.04)
tang_assets	-.0063166** (-2.34)	-.010540*** (-3.17)	-.0863847** (-2.22)	-.0567732+ (-1.41)	.0263773 (0.91)	.0244777 (1.13)
lnassets	-.0577729* (-1.94)	-.2541659** (-2.34)	2.352114*** (4.12)	1.798678*** (3.37)	.6212873 (1.16)	.4618905 (1.22)
leverage	-.0487769 (-0,15)	.6333148** (2.35)	-8.03469* (-1.86)	-3.606835 (-1.05)	1.140047 (0.63)	.9097058 (0.72)
Observations	627	627	706	706	707	707
R- Squared	0.3443	0.2428	0.2830	0.1095	0.0388	0.0189
F-stat	5.8	9.52	4.86		0.5	
Chi-Squared (for RE models)				50.75		5.59
p-value	0.0000	0.0000	0.0000	0.0000	0.9990	0.8483
Hausmann		0.0000		0.1414		0.7718

*+ p-value<0,25, * p-value<0,1, ** p-value<0,05, *** p-value<0,01*

Table 2.2: The results of the contestability regressions

REGRESSION RESULTS TOBINQ

variable	coefficients		coefficients	
	Pooled OLS	*Panel Data*	*Pooled Ols*	*Panel Data*
shrdifference2	.1403595 (0.66)	.0136534 (0.13)		
shrconcentration1			.0444551 (0.655)	-.039 (-0.46)
tang_assets	-.005774** (-2.23)	-.00777*** (-3.31	-.0066** (0.015)	-.00913*** (-3.76)
lnassets	-.05128** (-1.96)	-.25923*** (-3-38)	-.04731* (-1.66)	-.25495*** (-2.68)
leverage	-.1129099 (1.8)	.5451909** (2.03)	-.02944 (-0.28)	.58472** (2.2)
Observations	797	797	725	725
R- Squared	.3411	.2182	.3481	.2318
F-stat	7.72	10.94	7.2	12.54
Chi-Squared (for RE models)				
p-value	0.0000	0.0000	0.0000	0.0000
Hausmann		0.0000		0.0000

*+ p-value<0,25, * p-value<0,1, ** p-value<0,05, *** p-value<0,01*

REGRESSION RESULTS ROA

variable	coefficients *Pooled OLS*	*Panel Data*	coefficients *Pooled Ols*	*Panel Data*
shrdifference2	5.5842** (2.11)	2.6425+ (1.24)		
shrconcentration1			2.7188* (1.69)	.4088 (0.29)
tang_assets	-.6592* (-1.89)	-.0427+ (-1.12)	-0.7262** (-2.00)	-.0473+ (-1.2)
lnassets	1.9709*** (3.95)	1.6142*** (3.11)	2.234*** (4.21)	1.6301*** (3.05)
leverage	-7.7366** (-1.96)	-4.5837+ (-1.28)	-8.8711** (-2.12)	-2.9800 (-0.84)
Observations	909	909	813	813
R- Squared	.2429	0.0378	.2553	.035
F-stat	5.39			
Chi-Squared (for RE models)		42.19		37.14
p-value	0.0000	0.0000		0.0000
Hausmann		.4542		0.0750

*+ p-value<0,25, * p-value<0,1, ** p-value<0,05, *** p-value<0,01*

REGRESSION RESULTS PROFIT MARGIN

variable	coefficients *Pooled OLS*	*Panel Data*	coefficients *Pooled Ols*	*Panel Data*
shrdifference2	3.342+ (1.07)	1.564+ (1.19)		
shrconcentration1			1.8814 (1.03)	.9919 (1.04)
tang_assets	.025899 (0.94)	.0247 (1.09)	.02265 (0.9)	.0238 (1.1)
lnassets	.4740+ (1.17)	.3485+ (1.28)	.53060+ (1.17)	.40659+ (1.24)

leverage	.8579 (0.64)	1.0187 (0.83)	.5727 (0.46)	.94050 (0.79)
Observations	910	910	814	814
R- Squared	.0299	.005	.0322	0.0148
F-stat	0.52		0.5	
Chi-Squared (for RE models)		7.24		6.21
p-value	0.9979	0.5108	0.9988	0.6240
Hausmann		0.7514		0.7425

*+ p-value<0,25, * p-value<0,1, ** p-value<0,05, *** p-value<0,01*

Table 2.3: Impact of the nature of the first shareholder on the dependent variables

REGRESSION RESULTS TOBINQ (1)

variable	coefficients		coefficients	
	Pooled OLS	*Panel Data*	*Pooled Ols*	*Panel Data*
familyfirst	0.0502* (1.84)	.00024 (0.12)		
firstshrtype2	-.37285*** (-3.2)	.00671 (0.08)		
statefirst			-.0049 (-1.00)	-.00323+ (-1.48)
firstshrtype5			.12361 (0.55)	.091522 (0.86)
industrialfirst				
fisrtshrtype1				
financialfirst				
firstshrtype3				
shrdir1	-.00018 (-0.1)	-.000386 (-0.42)	.00184+ (1.22)	-.002516 (-0.33)
tang_assets	-.00646*** (-2.59)	-.007881*** (-3.48)	-.00590** (-2.28)	-.00783*** (-3.46)

lnassets	-.05597** (-2.13)	-.25903*** (-2.97)	-.05* (-1.89)	-.25802*** (-2.94)
leverage	-.1202 (-0.38)	.54692** (2.04)	-.10959 (-0.33)	.54612** (2.03)
Observations	797	797	797	797
R- Squared	.3560	0.2184	.3434	.2186
F-stat	7.91	9.15	7.48	10.05
Chi-Squared (for RE models)				
p-value	0.0000	0.0000	0.0000	0.0000
Hausmann		0.0401		0.04

*+ p-value<0,25, * p-value<0,1, ** p-value<0,05, *** p-value<0,01*

REGRESSION RESULTS TOBINQ (2)

	coefficients		coefficients	
variable	*Pooled OLS*	*Panel Data*	*Pooled Ols*	*Panel Data*
familyfirst				
firstshrtype2				
statefirst				
firstshrtype5				
industrialfirst	-.002892+ (-1.2)	-.00037 (0.26)		
fisrtshrtype1	.1683+ (1.47)	.04255 (0.55)		
financialfirst			.001817 (0.51)	.000557 (.026)
firstshrtype3			-.085366 (-0.63)	-.01990 (-0.22)

shrdir1	.002484+ (1.31)	-.00027 (-0.28)	.001443 (1.05)	-.00045 (-0.59)
tang_assets	-.006127** (2.39)	-.00787*** (-3.45)	-.00578** (-2.41)	-.00783*** (-3.48)
lnassets	-.04911* (1.86)	-.2557*** (-2.9)	-.05106* (1.94)	-.25764*** (-2.94)
leverage	-.13407 (-0.41)	.53839** (2.00)	-.11295 (-0.35)	.54568** (2.03)
Observations	797	797	797	797
R- Squared	.3448	.2187	.3434	.2184
F-stat	7.53	9.79	7.48	9.2
Chi-Squared (for RE models)				
p-value	0.0000	0.0000	0.0000	0.0000
Hausmann		0.0401		0.0404

*+ p-value<0,25; * p-value<0,1; ** p-value<0,05; *** p-value<0,01*

REGRESSION RESULTS ROA (1)

	coefficients		coefficients	
variable	*Pooled OLS*	*Panel Data*	*Pooled Ols*	*Panel Data*
familyfirst	.01668 (0.38)	.01 (0.3)		
firstshrtype2	-.4557 (-0.2)	-1.303 (-0.68)		
statefirst			-.038 (-0.81)	-.0357 (-0.63)
firstshrtype5			.42205 (0.16)	1.206 (0.58)
industrialfirst				
fisrtshrtype1				
financialfirst				
firstshrtype3				

shrdir1	.04552* (1.62)	.01933 (1.22)	.04927** (2.19)	.0230+ (1.42)
tang_assets	-.0740** (-2.11)	-.04483 (-1.17)	-.0739** (-2.11)	-.0439 (-1.15)
lnassets	1.954*** (3.89)	1.59*** (3.1)	1.967*** (3.81)	1.598*** (3.07)
leverage	-7.827** (-1.99)	-4.801 (-1.34)	-7.808+ (-1.49)	-4.716+ (-1.31)
Observations	912	912	912	912
R- Squared	.2436	0.0877	.2435	.0907
F-stat	5.4		5.21	
Chi-Squared (for RE models)		44.05		42.38
p-value	0.0000	0.0000	0.0000	0.0000
Hausmann		0.1879		0.3569

*+ p-value<0,25, * p-value<0,1, ** p-value<0,05, *** p-value<0,01*

REGRESSION RESULTS ROA (2)

variable	coefficients		coefficients	
	Pooled OLS	*Panel Data*	*Pooled Ols*	*Panel Data*
familyfirst				
firstshrtype2				
statefirst				
firstshrtype5				
industrialfirst	-.0253 (-0.63)	-.01453 (-0.61)		
fisrtshrtype1	1.968 (0.94)	2.443** (2.07)		
financialfirst			-.0279 (-0.71)	.0177 (062)
firstshrtype3			.73655 (0.4)	-.9823 (-.76)
shrdir1	.05415** (2.11)	.0224 (1.21)	.05631** (2.1)	.0191 (1.08)
tang_assets	-.0769** (-2.14)	-.04473 (-1.16)	-0.7694** (-2.14)	-.043 (-1.12)

lnassets	1.955*** (3.99)	1.629*** (3.17)	1.978*** (3.98)	1.593*** (3.11)
leverage	-7.972** (-2.04)	-5.057+ (-1.42)	-7.788** (-1.97)	-4.7486+ (-1.32)
Observations	912	912	912	912
R- Squared	.2448	.0841	.2442	0.09
F-stat	5.25		5.23	
Chi-Squared (for RE models)		49.91		42.64
p-value	0.0000	0.0000	0.0000	0.0000
Hausmann		0.2149		0.9457

*+ p-value<0,25, * p-value<0,1, ** p-value<0,05, *** p-value<0,01*

REGRESSION RESULTS PM (1)

	coefficients		coefficients	
variable	*Pooled OLS*	*Panel Data*	*Pooled Ols*	*Panel Data*
familyfirst	-.0434 (-0.95)	-.0169 (-0.86)		
firstshrtype2	3.488 (1.00)	1.173 (0.87)		
statefirst			-.0159 (-0.66)	.00308 (0.3)
firstshrtype5			.1732 (0.2)	-.5215 (-0.84)
industrialfirst				
fisrtshrtype1				
financialfirst				
firstshrtype3				
shrdir1	.0504 (1.04)	.02 (1.02)	.0341 (1.04)	.0146 (1.07)
tang_assets	.026 (0.94)	.0246 (1.08)	.0225 (0.9)	.02467 (1.08)
lnassets	.5294 (1.18)	.3677+ (1.25)	.4894+ (1.18)	.3581+ (1.28)
leverage	.9546 (0.67)	.9798 (0.81)	.7935 (0.61)	.9129 (0.8)

Observations	913	913	913	913
R- Squared	.0386	00174	.0322	.0146
F-stat	0.65		0.54	
Chi-Squared (for RE models)		6.92		6.98
p-value	0.9745	0.7331	0.9971	0.7270
Hausmann		0.2536		0.7270

*+ p-value<0,25, * p-value<0,1, ** p-value<0,05, *** p-value<0,01*

REGRESSION RESULTS PM (2)

	coefficients		coefficients	
variable	*Pooled OLS*	*Panel Data*	*Pooled Ols*	*Panel Data*
familyfirst				
firstshrtype2				
statefirst				
firstshrtype5				
industrialfirst	-.0205 (-1.02)	-.0102 (-1.04)		
fisrtshrtype1	1.249 (1.09)	.9033+ (1.21)		
financialfirst			-.0438 (-1.09)	-.0124 (-1.09)
firstshrtype3			2.187 (1.04)	.7497 (0.99)
shrdir1	.0394 (1.04)	.01687 (1.05)	.04236 (1.06)	.017 (1.09)
tang_assets	.0211 (0.89)	.024 (1.08)	.0205 (0.88)	.024 (1.08)
lnassets	.4838+ (1.17)	.35115+ (1.29)	.5101 (1.18)	.35+ (1.29)
leverage	.6589 (0.54)	.8335 (0.76)	.8109 (0.62)	.9437 (0.81)

Observations	913	913	913	913
R- Squared	.0327	.0156	.0336	.0151
F-stat	0.55		0.56	
Chi-Squared (for RE models)		7.83		6.72
p-value	0.9964	0.6452	0.9951	0.7513
Hausmann		0.6443		0.2390

*+ p-value<0,25, * p-value<0,1, ** p-value<0,05, *** p-value<0,01*

APPENDIX 3. An example of Stata software command string

```
xtreg TOBINq ashrdir1 ashrdir2 ashrdir3 tang_assets lnassets
leverage yeardummy2-yeardummy5, fe

estimates store fixed

xtreg TOBINq ashrdir1 ashrdir2 ashrdir3 tang_assets lnassets
leverage yeardummy2-yeardummy5, re

hausman fixed
```

Note: command used to calculate the regression of the shrdir variables on Tobin's Q with Advanced Panel Data

APPENDIX 4: Table 4.1. Vif (Variance Inflation Factor) results on the contestability regressions

variable	VIF	1/VIF
twosector22	38,45	0,02601
twosector33	30,59	0,03269
twosector41	28,93	0,03457
twosector13	24,39	0,04100
twosector14	23,08	0,04333
twosector32	22,10	0,04525
twosector21	21,61	0,04627
twosector18	21,24	0,04708
twosector24	16,58	0,06031
twosector23	15,57	0,06423
twosector9	14,70	0,06803
twosector7	14,26	0,07013

twosector31	13,13	0,07616
twosector8	12,39	0,08071
twosector43	10,96	0,09124
twosector4	10,90	0,09174
twosector29	10,55	0,09479
twosector17	8,93	0,11198
twosector20	8,01	0,12484
twosector1	6,62	0,15106
twosector19	6,51	0,15361
twosector3	5,52	0,18116
twosector11	5,02	0,19920
twosector34	4,99	0,20040
twosector45	4,57	0,21882
twosector15	4,53	0,22075
twosector25	4,50	0,22222
twosector42	4,13	0,24213
twosector35	3,62	0,27624
twosector16	3,58	0,27933
twosector26	3,57	0,28011
twosector37	3,57	0,28011
twosector12	3,57	0,28011
twosector38	3,56	0,28090
twosector44	3,55	0,28169
twosector39	3,13	0,31949
twosector30	3,11	0,32154
twosector28	3,11	0,32154
twosector36	3,02	0,33113
tang_assets	2,60	0,38462
twosector40	2,54	0,39370
yeardummy5	2,31	0,43290
yeardummy3	2,24	0,44643
yeardummy4	2,19	0,45662
twosector10	2,04	0,49020
twosector2	2,04	0,49020
lnassets	1,98	0,50505

yeardummy2	1,98	0,50505
leverage	1,72	0,58140
twosector6	1,54	0,64935
shrdifference2	1,39	0,71942
shrconcentration	1,37	0,72993
mean VIF	8,77	