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**Determinants of Corporate Governance in  
Italy: Path dependence or convergence?**

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# Determinants of Corporate Governance in Italy: Path dependence or convergence?

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## Abstract

We evaluate determinants of corporate governance of companies listed at the Italian Stock Exchange Market. As determinants we consider the ownership structure, balance sheet information, company performance and some qualitative features. We evaluate convergence of Italian companies' governance towards a system with effective governance mechanisms. Our analysis shows definitely that while the effect of forces contrasting convergence (large shareholder, companies belonging to a pyramidal group) work against convergence, those forces that should help convergence (monitoring by large blockholders, debt) do not succeed to guarantee effective governance devices. Only the stake of small shareholders positively affects governance features. Companies at the top of a pyramidal group or with a large fraction of shareholding in other companies over the book value are characterized by poor governance.

**JEL keywords:**G30,G34,G38

**Keywords:** Corporate governance, law, code of best practice.

# 1 Introduction

This paper aims to evaluate corporate governance of companies listed at the Italian Stock Exchange Market. We consider three main sources of information on corporate governance for each company: the 2002 by-laws, the 2002 statement on compliance with the code of best practice introduced in 1999 by the Italian Stock Exchange (the so called Preda report), the 2002 statement on compliance with the internal dealing code.

Our main goal is to investigate corporate governance determinants. To this end, we have collected data on company qualitative features, performance, balance sheet information and ownership structure in order to assess how they affect governance features. On this point Italian data are particularly interesting because we have been able to define the identity and the stake of all shareholders detaining more than 2% of the capital of the company. We do not look at an index of corporate governance as it is done in many papers, we concentrate on determinants of single corporate governance features.

Up to '90s, Italian financial markets were characterized by concentrated ownership, weak investor protection and State ownership. Financial intermediaries and institutional investors did not play an active role on monitoring companies and on their corporate governance, companies were mainly under control of the State or of families. The system was quite opaque and the stock market was underdeveloped, on the Italian financial market system and corporate governance see [Ciocca, 2000, Bianco and Casavola, 1996, Bianchi et al., 2001].

The start of the privatization process in 1992 was joined by a process of modernization of financial markets. The main goal was to increase investor protection favouring dispersed ownership and to make corporate governance effective. There are four main regulatory pieces that have affected financial markets and corporate governance in the last ten years: the Testo Unico Bancario in 1993 (TUB in what follows), the privatization law in 1994, the Testo Unico della Finanza (TUF in what follows) in 1998, the Preda code of best practice for listed companies in 1999. There are also some minor regulatory pieces by the Stock exchange authority (CONSOB) and by the Italian stock exchange such as the internal dealing code in 2002. Some of these norms are normative-impositive, some others have a dispositive nature, and some others have no impositive power at all. In particular, the code of best practice is an interesting example of self-organization: the Italian Stock Exchange and indirectly listed companies, being represented inside the Preda committee, agree on a set of rules on corporate governance to maximize the shareholder's value; companies are not forced to accept them, however they have to release a report on compliance with the code.

The Italian financial market is changing but not too much, ownership is still concentrated, hostile takeovers are quite rare, it is doubtful that institutional investors play an active role and that banks actively monitor companies.

In this paper we address three main points. First we look at corporate governance determinants in a country with the above features. The literature on corporate governance determinants mainly deals with the US experience, see [Agrawal and Knoeber, 1998, Denis and Sarin, 1999, Deli and Gillan, 2000, Adams and Ferreira, 2003], not to much is known for other countries, the only exceptions being provided by cross-country analyses considering an aggregate index of corporate governance, see [Klapper and Love, 2002,

Durnev and Kim, 2003], or papers addressing managers' turnover. While in a public company, governance devices have mainly to address the manager-shareholders conflict, the main problem in a system with a highly concentrated ownership is the exploitation of minority shareholders. So corporate governance problems are different and also governance devices may differ.

The second point is to test effectiveness of the new pieces of regulation introduced in the Italian financial market. It is not always easy to evaluate effectiveness of impositive rules, e.g. the fact that derivative suits have not been promoted by minority shareholders or that very few cases of insider trading have been detected does not mean that the regulation does not work, it could be that they play a deterrence role. It is easier to test effectiveness of dispositive rules or of a code of best practice: being based on a voluntary basis, we can evaluate the degree of compliance of companies. The degree of compliance is a signal of effectiveness. In what follows we mainly concentrate our attention on dispositive rules contained in the TUF and on the code of best practice.

Italy can be seen as a transition economy from a non well developed financial market to a "modern" financial market. By modern financial market we do not necessarily refer to the UK-US system, but only to a financial market where governance mechanisms work properly and the stock-debt market is developed. We have the opportunity to check for formal and functional convergence. A recent debate motivated by the literature on finance, law and growth, see [Rajan and Zingales, 1998, Levine and Zervos, 1998, La Porta et al., 1998, La Porta et al., 1997, Demirguc-Kunt e Maksimovic, 1998, Beck and Levine, 2001, Beck et al., 2001, Beck et al., 2002a], has posed the following question: Are corporate governance systems going to converge to the AngloSaxon type corporate governance model based on stock markets and diffused ownership? There are those who stress formal convergence driven by new legal rules increasing investor protection and those who stress that convergence will occur through more market based arguments such as market integration, free bargaining, self-regulation, see [Coffee, 1999, Coffee, 2000, Hansmann and Kraakman, 2000, La Porta et al., 2000]. On the other hand, there are those who point out path dependency on corporate governance which impedes convergence, see [Bebchuk, 1999, Bebchuk and Roe, 1999, Roe, 2000, Roe, 2002, Rossi, 2001]. The first thesis is mainly driven by a legal thesis and by the supremacy of the diffused ownership model to pursue efficiency and growth. The second thesis relies mainly on a political-incumbent thesis such that institutions and politics affect the corporate governance system. Advocates of the (functional) convergence thesis stress the relevance of self-regulation experiences: self-regulation precedes normative rules. The code of best practice can be interpreted as an experiment of functional convergence. In this perspective, testing for effectiveness of the new regulatory system we can evaluate convergence of the Italian corporate governance system. Looking for determinants of corporate governance we identify convergence driving forces and forces impeding it. Little research has been developed in this field. In a system with concentrated ownership we identify the following convergence driving forces: institutional investors (the stake detained by investment funds, banks, insurance companies), market (the stake detained by small shareholders), large blockholders who are not controlling the company, debt. On the other hand a company with the largest shareholder detaining a large stake or under strict control will be less inclined to introduce

governance rules that limit private benefits of control. We also expect companies on the top of a pyramidal group as well as companies characterized by a large fraction of shareholding in other companies over the book value to have a poor governance.

Convergence of the Italian corporate governance system towards an effective governance system and the analysis of the driving forces of the phenomenon represents the third point addressed in the paper. Our analysis shows definitely that while the effect of forces contrasting convergence (large shareholder, companies belonging to a pyramidal group) work against convergence, those forces that should help convergence (monitoring by large blockholders, debt) do not succeed to guarantee good governance devices. Only the stake of small shareholders positively affects some governance features. Companies at the top of a pyramidal group or with a large fraction of shareholding over the book value are characterized by poor governance.

The paper is organized as follows in Section 2 we briefly describe recent developments on Italian financial markets regulation. In Section 3 we review the literature on corporate governance determinants. In Section 4 we present the dataset used in our analysis. In Section 5 we provide the empirical analysis.

## 2 Financial markets and corporate governance in Italy in the last decade

Up to '90s, Italian financial markets were characterized by concentrated ownership, weak investor protection and State ownership. The financial system was neither market based nor bank based, companies were mainly under control of families directly, through pyramidal systems and/or through coalitions-cross holding. Financial intermediaries did not play an active role on corporate governance. The system was quite opaque and the stock market was underdeveloped, on the Italian financial market system and corporate governance see [Ciocca, 2000, Bianco and Casavola, 1996, Bianchi et al., 2001].

The start of the privatization process in 1992 was joined by a process of modernization of financial markets. The main goal was to increase investor protection favouring dispersed ownership, to help financial markets development and to make corporate governance effective. There are five main regulatory pieces that have affected financial markets and corporate governance in the last ten years and that are relevant to our analysis: the Testo Unico Bancario in 1993, the privatization law in 1994, the Testo Unico della Finanza in 1998, the code of best practice in 1999, the internal dealing code in 2002.

We have already pointed out that the TUB mainly allows commercial banks to detain stakes in non financial companies. For fifty years commercial-retail banks could not hold stakes in non financial companies. The privatization process is relevant in our research for two main reasons. First of all, it has reduced the presence of the State in the economy, and in particular banks are not anymore (at least in part) under the control of the State; second it contributed to raise the debate on corporate governance and financial markets in Italy, political parties discussed for a long time on the best way to privatize companies, see [Fulghieri and Zingales, 1994, Jaeger, 1995, Marchetti, 1995]. The law on *privatizzazioni*

(law nr. 474, 30 luglio 1994) introduced some relevant norms for privatized companies: golden share, limits to shareholding, *voto di lista* to appoint directors of the board and members inside the board of auditors (with 1% as threshold), mailing vote. [Marchetti, 1995] notes that the law allowing representativeness of minority shareholders inside the board of auditors implicitly recognizes that the board plays a role on monitoring the management rather than pure accounting monitoring. According to the Civil code, directors and auditors are appointed on a majority rule basis; the *voto di lista* mechanism introduced some proportionality in the representation inside the board of directors: shareholders with a stake above a certain threshold may present a list, then directors are chosen among those indicated in the lists on a pure proportional basis or according to rules establishing that the majority of directors is in any case drawn by the most voted list. In the case of the board of auditors, things are different: one over three auditors or two over five auditors are chosen by the lists that have not received the relative majority of votes.

The TUF establishes a new regulation on takeovers, allows cross-holding below 5%, introduces a strict regulation on the flow of information to the market and reinforces shareholders' rights. On this point, the main innovations are the following: shareholders quorum to convene a shareholders meeting (from 20% to 10%), quorum to appeal to the board of auditors (from 5% to 2%), quorum to appeal to the court against CEOs and auditors (from 10% to 5%), 5% as a quorum to promote *azione di responsabilità* without shareholders' meeting approval (as before the TUF), extraordinary shareholders meetings require a 2/3 quorum and not simple majority as before, minority shareholders can be represented inside the board of auditors (one over three or two over five members); control on the management is assigned to the board of auditors, control on accounting is assigned to the *società di revisione*; proxy voting through banks is allowed. The TUF regulates the flow of information from executive directors to the board of auditors. Moreover, the TUF gives large space to *autonomia statutaria*: companies can provide stronger investor protection (lower quorums, proxy and mail voting, size of the board of auditors) on their by-laws, see [Ferri, 1999, Montalenti, 2002]. For a different interpretation on the TUF see [Visentini, 1998], the author points out that the TUF tends to reinforce stability of control groups and to orient the system towards a bank centred model, among the innovations oriented in this direction he refers to the extension of cross-holding to 5% and to the fact that banks are allowed to detain shares of companies. However, according to the index on investor protection computed by [La Porta et al., 1998, La Porta et al., 1997], after the TUF Italy goes from 1 to 5 over 6. Efficiency of corporate governance is handled by the TUF through external governance mechanisms (takeovers and surveillance by the CONSOB), through ex post legal actions by shareholders and by the board of auditors.

It is difficult to evaluate the effect of the TUF on financial markets and corporate governance. [PricewaterhouseCoopers, 2000] investigates the corporate governance of more than one hundred of listed companies and large privately held companies. Some of their results are interesting for our analysis. Only 3% of companies have a by-laws establishing that independent directors should be appointed inside the board, only 9% of companies have introduced the *voto di lista* mechanism. Only 54% of companies have the chairman of the board of directors separated by the CEO. Only 2% of companies are characterized by limits

to multiple directories. Only 4% of companies have adopted a code of conduct regulating the activities of the board of directors. 74% of companies do not have specialized committees inside the board (committees are mainly adopted by banks). Conditional upon the institution of a committee, only 12% of companies have independent directors inside the committees. Only 10% of companies have adopted an internal control committee. Only in 25% of companies, auditors representing minority shareholders have been appointed in the board of auditors. As far as minority shareholders' rights that can be extended by the by-laws, results are striking: only 2% of companies have established a quorum lower than 10% to convene a general shareholders meeting, no company has established a quorum lower than 2% to appeal to the board of auditors, no company has established a quorum lower than 5% to appeal to the court against CEOs or auditors, no company has established a quorum lower than 5% to promote *azione di responsabilità*. Only 3% of companies have established a quorum higher than 2/3 for extraordinary shareholders meetings. 5% of companies allow vote by mail and 4% of companies help proxy voting.

Ex post legal rights have not been exerted by minority shareholders, see [Spaventa, 2002]. As a matter of fact, only once an extraordinary general shareholders meeting has been called by minority shareholders and only in one extraordinary general shareholders meeting the quorum of 2/3 was not reached to approve a merger. Mail voting is included in a small percentage of companies' by-laws and has never been exerted in the last two years. Proxy voting is not used, in no general shareholders meeting we have assisted to a solicitation of votes. No *azione di responsabilità* has been promoted by minority shareholders.

These facts are striking. They say some interesting things. First, *autonomia statutaria* does not help to reinforce investor protection, almost no company has introduced more stringent rules to protect minority shareholders, see [Montalenti, 2002]. An enlightening example is provided by the board of auditors, companies can opt for three to five effective members. Excluding some privatized, State owned and some banks, almost all the companies opted for three effective members. Probably, the rationale for this choice is that two auditors can convene the board of directors and the general shareholders meeting. Second, shareholders' rights have not been exerted frequently since the TUF, this observation does not mean that they are not relevant, shareholders' rights may well act as a deterrent. Third, the TUF has not affected the internal governance of companies and therefore the main reference continues to be the Civil Code (1942). The Civil Code is not designed to make the company work in an efficient way; as a matter of fact, the Civil Code does not provide many insights on the management of the company. According to the Code there is a *supremacy of ownership*, almost no word is dedicated to powers of managers, i.e., they are deduced from those assigned to the shareholders' meeting (art. 2364-2365) and from the fact that they can be charged for bad management through an *azione di responsabilità* after a vote by the shareholders meeting (art.2393). Vagueness of the code is impressive: directors *devono adempiere i doveri ad essi imposti dalla legge e dall'atto costitutivo con la diligenza del mandatario*, i.e., duty of fairness and care (art. 2392), see [Ferrara and Corsi, 1994, Preite e Magnani, 1994, Pavone La Rosa, 1997]. In the commercial law literature there is a debate on the role of directors, there are even those (a small minority) who interpret directors' duties through the *mandato* relationship opposed

to those who interpret the role of directors as an office distinct from the general shareholders meeting. The management of the company should be directed to achieve the *interesse sociale* (social interest) which is not necessarily the shareholder value, on the point see [Jaeger, 2000, Ferrarini, 2002].

The Preda best practice code concentrates on corporate governance defined as the system of rules according to which the company is managed and controlled. The main goal of the recommendations of the code is the maximization of the shareholder value under the assumption that a good governance system will have good effects also on other stakeholders. So the code of best practice sticks to the shareholder value maximization supremacy, see [Ferrarini, 2002, Hansmann and Kraakman, 2000].

We concentrate our attention on the following topics addressed by the Preda Code:

*Role of the board of directors.* The Preda report recommends that companies define exclusive powers of the board of directors. The report includes among exclusive powers of the board the approval of strategic plans, of significant transactions and of transactions with related parties. Executive directors (including in case the chairman) shall have delegated powers defined by topic and/or by monetary upperbounds. Transparency on delegated powers is expected.

*Composition of the board of directors.* The report identifies two classes of directors: executive and independent directors. Non-executive directors shall balance executives' views in taking board decisions consistent with shareholders' interests. An adequate number of non-executive directors shall be independent. Independency is a subjective property, it refers to independency from owners, from the company and from executive directors. Independent directors shall not own a quantity of shares enabling them to exercise a considerable influence in controlling the company.

*Role of the chairman of the board of directors.* The chairman shall call meetings of the board, shall co-ordinate the activities of the board, in particular shall provide information-documentation to members reasonably in advance of the date of the board meeting.

*Information to the board on delegated powers.* The executive committee and managing directors shall periodically report to the board of directors and board of auditors on the activities performed in the exercise of their delegated powers.

*Confidential information.* Managing directors shall define a procedure to handle price sensitive and confidential information.

*Appointment of directors.* Proposals for appointments to the position of director, accompanied by detailed information, shall be deposited 10 days before the shareholders' meeting. The same recommendation is made for appointments to the board of auditors. In case an appointment committee is established, the majority of the committee shall be made of non-executive directors.

*Remuneration of directors.* The board of directors shall form a committee on remuneration. The committee, the majority of whose shall be non executive directors, shall submit proposals to the board on the remuneration of managing directors and of directors who are appointed to particular positions. Proposals are taken avoiding conflicts of interests. A part of the remuneration shall be linked to the company's profitability-achievement of specific goals.



*Internal control.* The board of directors shall define an internal control system to monitor the efficiency of the company's operations. The board of directors shall establish an internal control committee, charged with the task of making proposals on the control system.

*Transactions with related parties and conflict of interests.* Transactions with related parties shall comply with criteria of fairness. Directors who may have conflicts of interest on some specific decisions shall abandon the board.

*Relations with institutional investors.* The board shall designate an investor relator.

*Shareholders' meetings.* Directors shall encourage participation of shareholders. A set of rules for the conduct of the general shareholders meeting shall be defined.

The code stresses the monitoring role of the board, the board maintains a central role in defining strategic plans and delegated powers, but the management of the company is mainly delegated to executive directors. The code also requires an explicit procedure for the flow of information among the offices inside the company and between the company and shareholders-market.

Recommendations included in the report are similar to those adopted in countries with well developed markets and companies with diffused ownership. A system with concentrated ownership may need a regulation different from that adopted in countries with dispersed ownership. Note that Italy has been one of the last developed countries to adopt a code of best practice. [Rossi, 2001, Spaventa, 2002] point out serious doubts on the effectiveness of the code. They point out that the code does not address the main negative peculiarities of the Italian financial system: interlocking directories (there is no limit to multiple directorships) pyramidal groups, blocking minorities, extensive cross-holding, non transparency on decisions taken by coalitions. [Rossi, 2001] distinguishes two classes of minority shareholders: sophisticated institutional investors who actively participate in the company life (who exert their voice), small minority shareholders who own a small stake and mainly exert the exit route. While in the first case high disclosure standards (towards shareholders) and inside organization of the control-management of the company play a relevant role, the only way to protect unsophisticated shareholders is to introduce pervasive and effective imperative rules (with specific attention to mergers, acquisitions, takeovers). According to the author, self-organization is effective only when institutional-sophisticated investors play an active role. As a matter of fact, codes of best practice are designed to make the exercise of the voice more effective but have no effect when exit is the only choice for small shareholders. A code of best practice is intended to make a public company work well and not to protect minority shareholders.

The internal dealing code concerns the release of information to the market on trades made by the top management. The code has established that there are two thresholds; if during a trimester a top manager has traded shares of its own company for a value higher than 50.000 euros, then he has to report this fact to the Italian Stock Exchange, if the manager has traded shares for a value larger than 250.000 euros then he has to report this fact promptly to the Italian Stock Exchange. Then the Italian Stock Exchange puts this information on the web. The two thresholds are quite high (higher than in US), but companies are allowed to reduce them.

Summing up the TUF does not affect companies' governance, it reinforces shareholders'

rights but the new rules do not seem to be effective. The code of best practice has introduced internal corporate governance rules that are designed to pursue the shareholder value in a public company system.

Observing ownership structure of listed companies, some form of convergence is observed, see [Consob, 2002] and Table 1. In 1996 the largest shareholder of listed companies owned on average 50.4%, in 2002 the stake is decreased to 40.7%; the stake detained by the market (shareholders with a stake smaller than 2%) increases from 38.9% to 51.2%. As far as the identity of shareholders with stakes above 2%, the main novelty is that the State owned 32.5% of the market in 1996 and only 12.3% in 2002. So the privatization process succeeded to decrease State ownership. Banks and institutional investors have not increased their shareholding in listed companies. Since 1993 banks are allowed to detain stakes in non financial companies, however the level of banks' participation as shareholders, excluding shareholding due to financial restructuring plans, is quite limited, see [Bianco and Chiri, 1997]. The most interesting observation concerns the control structure of companies. Consob classifies four types of control: companies controlled by absolute majority (the largest shareholder owns more than 51%), companies controlled de facto (the largest shareholder owns less than 51%, but exerts control), companies controlled by a coalition, non controlled companies. The weight of companies without control in 2002 is equal to that in 1996. The weight of non controlled companies reached a peak in 1998 and then came down to the level of 1996. In line with the decrease of the average stake of the first shareholder, the weight of companies controlled by absolute majority decreased, but on the other hand the weight of companies controlled de facto or through a coalition has gone up. It is difficult to assess this tendency as a convergence towards the public company system. In a system with low investor protection and high private benefits of control, control through a coalition or de facto is a bad thing. The phenomenon is similar to what has been observed for foreigner companies listing in US, see [Doidge, 2003].

year	% first shareholder	% shareholders above 2%	% market	absolute majority	controlled de facto	controlled by a coalition	non controlled
1996	50.4	10.7	38.9	66.8	12.2	4.8	16.2
1997	38.7	8.4	52.9	48.1	12.4	6.3	33.2
1998	33.8	9.7	56.5	32.3	21.7	7.4	38.6
1999	44.2	8.2	47.6	55	16.7	10.8	17.5
2000	44	9.4	46.6	51.4	18.5	9.6	20.5
2001	42.2	9.2	48.6	49.7	22.5	11.4	16.4
2002	40.7	8.1	51.2	46	28.4	10.2	15.4

Table 1: Ownership structure and Control

Separation between ownership and control has been achieved in Italy through pyramidal groups, [Bianchi et al., 2001] show that in 1993 ownership of one unit of capital of listed companies allowed ultimate control of 2.7 units on average, the ratio went down in 1996 to 1.95. Note that, non voting shares (*azioni risparmio*), albeit they have been allowed since the reform in 1974, account for a small quota of the market, in 1997 the percentage was only 8.4. [Zingales, 1994] showed that the voting premium (differential between the price of voting shares and non voting shares) was extremely high in the Italian stock exchange

market up to '90s (82%), however the premium has decreased in a significant way in the last years (after the TUF approval), see [Linciano, 2002].

Some papers have evaluated the role of classical corporate governance mechanisms in the Italian system. [Bianco and Casavola, 1999] analyze the effects of ownership structure on company performance. Results are not clearly cut. However, belonging to a pyramidal group, stability of control and a large stake by the owner (above 66%) induce a negative effect on ROI. [Volpin, 2002] shows that Tobin's Q is significantly smaller in firms where the manager is also the owner and it is small even in companies belonging to a pyramidal group, curiously enough companies controlled by a voting syndacate are characterized by a high Tobin's Q. Therefore, some peculiarities of the Italian financial market (pyramidal groups and highly concentrated ownership) have a negative effect on company evaluation. Ownership structure affects top executive turnover, see [Volpin, 2002, Barontini and Caprio, 2002]. Turnover is negatively related to performance and to the manager being an owner, if this is case then also the relation between performance and turnover becomes weaker, and turnover of top executives is insensitive to company performance when it is at the top of a pyramid.

[Bianchi and Enriques, 2001] analyze the role of institutional investors in the financial market. They show that in 1998 there were 292 stakes above 1% detained by institutional investors, the overall participation of institutional investors as a whole is greater than 1% in 162 companies, greater than 5% in 106 companies and greater than 10% in 52 companies. Institutional investors invest more in public companies than in companies controlled by absolute majority. However, the role of institutional investors as corporate governance device is weak, in [Belcredi et al., 2002] it is shown that their participation to general shareholders meetings is not sensitive to the company performance.

### **3 On the determinants of corporate governance**

The literature on corporate governance is quite large. One of the main topic addressed in the literature is the relationship among corporate governance arrangements, firm value, ownership structure and firm features. The main obstacle in this perspective is given by the fact that there is no clear causality connection among the four ingredients. Almost all the papers look for a relationship between corporate governance arrangements, ownership structure and firm valuation-performance. So the idea is that ownership structure and corporate governance arrangements are an exogenous datum affecting firm performance. While the connection between ownership structure and firm performance-valuation is not clearly established, the literature has established that in general good corporate governance and investor protection are highly correlated with good operating performance-market evaluation, see [Black, et al., 2003, Klapper and Love, 2002, La Porta et al., 2001, Gompers, et al., 2001]. This is only in part true, there are many reasons to believe that all these studies suffer reverse causality-endogeneity problems. On this point see also [Himmelberg, 2002, Himmelberg et al., 1999] Firm performance can affect corporate governance (in a positive way) for two main reasons. Insiders can use a good corporate governance as a signal to outsiders that they behave well in order to reduce asymmetric information and agency costs; second, if the firm performance

is good, then insiders (managers and owners) do not fear outsiders-takeovers and allow a good governance system. Ownership structure can affect corporate governance through a very simple argument. Private benefits of control are associated with a large stake. Any improvement of transparency, and outside monitoring diminishes private benefits of control, therefore the large shareholder controlling the company will not allow a good governance system. On the other hand, institutional investors, blockholders not controlling the company should induce the company to adopt good governance mechanisms. Also banks should tightly monitor the governance of a leveraged company.

In our analysis we do not address the effect of corporate governance on firm evaluation-performance, we reverse the perspective. We are interested in corporate governance determinants and in checking effectiveness of the new pieces of regulation by looking at how companies with different ownership structures and firm features-performance comply with them. Italy provides an interesting case study, as we have shown above internal corporate governance mechanisms were very weak in 1998, after the TUF and the code of best practice introduction companies went through a deep reorganization of their internal structure. According to this perspective, the 2002 corporate governance status can be seen as the outcome of a deep reorganization.

A small literature concerns the determinants of corporate governance. We have papers analyzing how ownership structure and company features affect corporate governance devices functioning (e.g. takeovers) and papers analyzing determinants of governance decisions-features. We concentrate on the second class of papers.

Among governance decisions-mechanisms, we have executive turnover. If corporate governance works, then CEO turnover should be related to the company performance (stock returns, ebit changes). Evidence confirming this link has been obtained for many countries (US, UK, Japan, Italy, emerging markets), see [Weisbach, 1988, Kaplan, 1994, Kaplan, 1994a, Kang and Shivdsani, 1995, Franks et al., 2003, Volpin, 2002, Gibson, 1999]. Some papers point out that ownership structure affects the relationship: [Gibson, 1999] shows that CEOs of poorly performing firms with a large shareholder in emerging markets are not more likely to lose their jobs; [Weisbach, 1988, Denis et al., 1997] show that the relation between turnover and performance in US is positively affected (and therefore the effect is weaker) by the stake detained by officers-directors and is negatively affected by the stake detained by outside blockholders, moreover companies with a large stake detained by officers (outside blockholders) are characterized by a smaller (higher) probability of CEOs turnover. In [Denis et al., 1997] no effect of institutions' ownership on CEOs turnover is detected. The result on executive directors' ownership and turnover (on its probability but not on its sensitivity to performance) has been confirmed for the UK market in [Franks et al., 2001, Renneboog and Trojanowski, 2003], but no effect associated with institutions, non-executives and outside shareholders' ownership is detected. If the CEO is the owner-founder of the company then the probability of turnover is smaller, see [Denis et al., 1997, Volpin, 2002].

There is a small literature on the determinants of internal governance mechanisms. [Deli and Gillan, 2000] show that the demand for an independent and active audit committee is positively related to the demand for accounting certification: the likelihood of a

firm having a completely independent and active audit committee is negatively related to firm growth opportunities (measured through the market value to the book value ratio) and managerial ownership and positively related to firm size (market value of equity plus book value of debt) and leverage (long term debt to firm size). [Denis and Sarin, 1999] show that the percentage of independent directors is positively affected by the log of the market value of equity, by the leverage ratio and negatively by ownership of directors and growth opportunities (measured by the industry's median market-book ratio). [Agrawal and Knoeber, 1998] show that the percentage of outside (non-executive) directors is negatively affected by insider shareholding, but not in a significant way, a negative and significant effect is associated with the fact that the founder is also a CEO. [Adams and Ferreira, 2003] show that the percentage of non executive directors increases when the CEO is also the chairman of the board and that a nonlinear relation holds between the percentage of non executive directors and insider shareholding: as insider shareholding increases, the percentage of independent directors first decreases and then increases. [Klapper and Love, 2002] analyze determinants of corporate governance by considering the corporate governance rankings for 495 firms across 25 emerging markets by Credit Lyonnais Securities Asia. As determinants of corporate governance they consider the following variables: legal system (shareholder rights, judicial efficiency, legality), sales (as a proxy of size), sales growth, capital-sales ratio (as a proxy of capital intensity). According to their model, the legal system, sales growth should have a positive effect on governance rankings, the effect of the capital-sales ratio should be negative and the effect of sales should be ambiguous. Empirical evidence confirms these hypotheses.

There is a limited, but growing, literature on codes of best practice. We refer the reader to [Denis and McConnell, 2003] for a survey. Papers mainly deal with the effects of codes of best practice on firm valuation and CEO turnover. [Dahya et al., 2000] address the effect on board effectiveness of the UK best practice code (Cadbury Committee report). The report recommends that boards of UK corporations include at least three outside directors and that the positions of chairperson and CEO be held by different individuals. Authors show that CEO turnover increased following the issuance of the Code and that the inverse relationship between CEO turnover and company performance was strengthened after the publication of the code. [DeJong et al., 2001] analyze the effect of the self-regulation experience in Netherlands (the best practice code proposed by the Peters committee). Authors find weak impact-effect of the code on firm valuation (Tobin's  $q$ ) and corporate governance, the main positive result is that the negative impact on firm performance due to concentrated ownership reduced after the Peters code has been promoted. Authors look for an explanation of firm performance through ownership data (largest blockholder, financial institution blockholdings, bank blockholdings, insider blockholdings) and some general features of the corporate governance of the company (dual listing, takeover defenses, structured regime, priority-preference shares, interlocked directories). They compare corporate governance structure pre and post Peters committee, they observe an increase in voluntarily retained structured regime and in listing abroad, and a decrease in priority shares and in the stake of the largest blockholder. Moreover, companies listed after the Peters committee reports have better governance. [Drobetz, et al., 2003] collect a dataset on specific aspects of corporate governance which are recommended by the German corporate governance code.

As in Italy, either companies comply with the recommendations or explain the reason of the non compliance choice. Authors build a rating of governance proxies by considering five categories of pieces of information: governance commitment, minority rights, transparency, management and supervisory board matters, auditing. The analysis is based on data collected through a questionnaire sent to companies listed in the German stock market. The response ratio is 36%, the sample size is made of 91 observations over a population of 253. The market value-to-book ratio is positively related to the rating of governance proxies. As far as expected returns is concerned, a negative relationship between them and corporate governance is observed: companies with a good corporate governance can reduce their cost of capital. The rationale for this result is that a good corporate governance reduces agency costs and therefore a lower cost of capital is observed.

## 4 The Dataset

To get a picture on corporate governance of companies in 2002 we consider three pieces of information: the 2002 by-laws, the 2002 statement on compliance with the code of best practice introduced in 1999 by the Italian Stock Exchange (the so called Preda report), the 2002 statement about compliance with the internal dealing code. On the size of board of directors and on the size of the board of auditors we rely upon official data by CONSOB.

We exclude companies belonging to the *mercato ristretto* (a market for small companies) and we exclude companies based as exchange market in other countries (e.g. STM electronics, Banco de Bilbao, Banco de Santander), then we are left with a sample of 270 companies, 29 companies belong to the Mib30 index, 43 to the Nuovo mercato segment and 38 to the Star segment.

Companies are not forced to meet the recommendations of the Code of best practice, but they are forced to evaluate their compliance with the code each year. The board of directors presents each year a report on the corporate governance to the shareholders meeting pointing out how the company has met the recommendations of the Code. These reports are available on-line ([www.borsaitalia.it](http://www.borsaitalia.it)). The code has been promoted by the Preda Committee in 1999, companies started to comply with the code in 2000, reports are available on-line for 2001 and 2002. We collected the 2002 reports. We consider 2002 reports because some inertia was observed on the compliance with the code in 2001. Some companies do not comply with the code and for them we do not have any information on corporate governance. Borsa Italiana exploiting the relationship between effective corporate governance and company evaluation has introduced a market segment (Star) dedicated to companies with a high standard of corporate governance. To belong to the Star segment, the board of the company should include 1/3 of independent directors, an internal control committee made up mainly of non executive directors should be introduced, a significant part of top executives remuneration should be contingent on performance, the company should appoint an investor relator to handle relationships with shareholders.

We consider the following features on corporate governance: the size of the board of directors (NUMAM), the fraction of independent directors (PERCIND), a dummy variable

Variable	Definition
Internal organization	
NUMAM	board size (number of directors)
PERCIND	% of independent directors
PRESAM	the chairman of the board is also a CEO
PRESIND	independent chairman
INFORM	information before appointment on candidate directors
LIMDEL	definition of delegated powers (from the board of directors to CEO)
ESCLU	exclusive powers of the board (by topic or by amount)
PAR	exclusive powers about transactions with related companies
COMCON	internal control committee
COMNOM	appointment committee
COMRE	remuneration committee
INVREL	investor relator
LISTA	voto di lista to appoint directors
INFOPRE	information to directors before board meeting
PERCONV	% of the board to convene the board
LISTASIN	Quorum to present a lista to appoint auditors
CONTRINT	internal control system
REGO	assembly conduct rules
NUMSIN	board of auditors size
SINDMIN	a member of the board of auditors represents minority shareholders
PARTCOM	the board of auditors participate to internal committees meeting
REMVAL	directors' remuneration related to company's performance
AMMPRE	CEO and chairman remuneration related to firm performance
DIRIG	management remuneration related to firm performance
Internal dealing	
TRIME	the threshold for trades over a trimester
TEMPE	the threshold for prompt communication of trades
BLACKDA	managers cannot trade during some windows
company features	
PUB	public utility
BAN	bank
ASS	insurance company
LMKT	log of market capitalization (log of the average of the 2000 and 2001 value)
LBOOK	log of book value (log of the average of the 2000 and 2001 value)
LMEDFATT	log of market capitalization (log of the average of the 2000 and 2001 value)
FINPAR	holding company
PRIVAT	privatized company
IPO	ipo
PIRA	belonging to a group (the owner is another company)
DUAL	dual listing in UK or US
DEBTT	total debt
RBOOK	growth of the book value (average of the 1999-2000 and 200-2001 value)
PARTB	partecipazioni over the book value
LEV	DEBTT/BOOK
performance	
MBVBV	MKT/BOOK
ROE	Roe
QTOBIN	Q Tobin
Ownership	
PRIMAZ	% of shares detained the first shareholder/coalition
MER	% of shares detained by minority-small shareholders (less than 2%)
SYND	shares of a voting coalition
AZDUE	% detained by shareholders with more than 2% less PRIMAZ or SYND
CONTRDIR	control by law (the first shareholder detains more than 51%)
CONTRFA	control de facto (the first shareholder detains less than 51% but he exerts control)
CONTRSIN	control by a voting coalition
NONCONTR	no control
CONTRSTA	State control
OWNMAN	CEOs are also owners (in case of CONTRDIR or CONTRFA)
OWNPRE	the chairman of the company is also an owner (in case of CONTRDIR or CONTRFA)
DOWN	either the CEO or the chairman are owners
PERCMAN	% of shares detained by managers
PERCPRE	% of shares detained by the chairman
FONDI	% of shares detained by funds above 2%
SGR	% of shares detained by Italian funds and foreigner funds above 2%
ISTIT	% of shares detained by institutional investors (banks, insurance companies, investment funds)

Table 2: Definition of variables

assuming value equal to one if the voto di lista is used to appoint directors and zero otherwise (LISTA), a dummy variable assuming value equal to one if information on candidate directors is released according to the code recommendations (INFORM), the fraction of the board of directors required to convene the board (PERCONV), a dummy variable assuming value equal to one if the chairman of the board is independent (PRESIND), a dummy variable assuming value equal to one if the chairman of the board is the controlling shareholder of the company (OWNPRE), a dummy variable assuming value equal to one if a CEO of the board is the controlling shareholder of the company (OWNMAN), a dummy variable assuming value equal to one if the chairman of the board or the CEO are the controlling shareholder of the company (DOWN), a dummy variable assuming value equal to one if the chairman of the board is also the CEO of the company (PRESAM), a dummy variable assuming value equal to one if an internal control committee has been introduced (COMCON), a dummy variable assuming value equal to one if a fully independent internal control committee has been introduced (COMCONI), a dummy variable assuming value equal to one if an internal control system is at work (CONTRINT), a dummy variable assuming value equal to one if a remuneration committee has been introduced (COMRE), a dummy variable assuming value equal to one if an appointment committee has been introduced (COMNOM), the size of the board of auditors (NUMSIN), the threshold necessary to present a list to appoint members of the board of auditors (LISTASIN), a dummy variable assuming value equal to one if the chairman of the board provides information to directors before board meeting (INFOPRE), a dummy variable assuming value equal to one if delegated powers are defined by topic and/or by a monetary upperbound (LIMDEL), a dummy variable assuming value equal to one if powers exclusive of the board of directors are defined (ESCLU), a dummy variable assuming value equal to one if there is an investor relator (INVREL).

A company also issues a report on the compliance with the internal dealing code. The Italian Stock exchange market has released a document showing for each company the following pieces of information: the threshold on trades for prompt communication, the threshold on trades during a trimester for communication at the end of the trimester, presence of black window periods, inclusion or not of stock option trades to count for the threshold. We consider two dummy variables: a dummy variable assuming value equal to one if the trimester threshold is larger than 25.000 euros (TRIME), and a dummy variable assuming value equal to one if the threshold for prompt communication is larger than 125.000 euros (TEMPE). Companies can decide to introduce periods of time during which top managers cannot trade shares of the company, a dummy variable is considered assuming value equal to one if such periods are established (BLACKDA).

We collected data on qualitative features of companies, on their performance and on ownership structure.

As far as ownership structure is concerned, we start by considering that 2002 corporate governance-internal dealing reports as well by-laws are prepared and conceived by the end of 2001, so we consider the ownership structure by the end of 2001 as the relevant datum. All information is gathered by CONSOB official release. Each stake above 2% is identified by the percentage of shares of the company, the direct shareholder and the ultimate shareholder (*dichiarante*). The direct shareholder in many cases is another company, the ultimate share-



holder is the relevant one. In case of a family, we grouped all the stakes owned by people of the family and we assign it to the family unless it was well known that members of the family do not agree on the management of the company. In case of a person who detains a certain stake directly and a stake through a company we grouped them and we assigned the stake to him. As an additional information we consider details on all coalitions (*patti di sindacato*) that were in force by the end of 2001, details on coalitions involving shareholders of listed companies are made public since the TUF on the official web site of CONSOB. Note that there are many forms of coalition, a coalition may deal with voting at the general shareholder meeting, talks about the management of the company and decisions to be taken by the board of directors, option or preemptive duty on selling shares.

Shareholders' stakes are managed depending on the ownership structure and are grouped in three categories: the controlling shareholder or the largest shareholder (PRIMAZ), shareholders with a stake above 2% who do not participate to a coalition controlling the company (AZDUE), shareholders holding a stake below 2% (MER). While MER is obtained as a residual from data, it is difficult to classify a shareholder as belonging to PRIMAZ or AZDUE. We proceeded as follows: in companies classified by CONSOB as non controlled we consider PRIMAZ as the stake detained by the largest shareholder, in companies controlled by absolute majority or de facto with no coalition agreement we consider PRIMAZ as the stake detained by the largest shareholder, in companies characterized by a coalition among shareholders (independently of its nature), PRIMAZ is given by the stake of all shareholders participating to the coalition. We assume that any form of patto di sindacato is relevant to define a coalition controlling the company. We also consider the stake detained by the chairman of the board (PERCPRE) and the stake detained by CEOs (PERCMAN).

We consider institutional investors. We consider the stake detained by banks and insurance companies (BANASS), Foundations (FONDA), investment, pension, private equity, venture capital funds (FONDI) and we consider also the sum of the three stakes (ISTIT). We also collected data on all the stakes detained by Italian investment funds and we consider the cumulative datum (PERCSGR).

We classify companies according to how control is exerted. Following criteria adopted by CONSOB we divide companies in four classes: companies controlled by absolute majority, i.e., when a shareholder or a family owns more than 51% (CONTRDIR), companies controlled de facto, i.e., companies with a large shareholder who exerts control on the management by appointing directors or by interfering on its management (CONTRFA), companies characterized by the fact that shareholders have signed an agreement on its management (CONTRSIN), non controlled companies (NONCONTR). Depending on the controlling subject, we have the following dummy variables: CONTRSTA if the controlling shareholder is the State or a local authority, CONTREST if the controlling shareholder is foreigner, PIRA if the controlling shareholder is another company (the company belongs to a pyramidal group).

Qualitative features of a company are important in our analysis. In what follows we consider the following features: IPO taking value equal to one if the company listed in the market in the last four years, PRIVAT taking value equal to one if the company has been privatized during the last ten years, DUAL if the company is listed in UK or US (there are only seven companies listed in these markets), BAN if the company is a bank, ASS if the

company is an insurance company, FINPAR if the company mainly owns other companies with no proper activity.

As we would like to escape endogeneity problems, we do not consider contemporaneous balance sheet information, valuation and performance measures. We consider data on 2000 and 2001 and we proceed to average the values. Data are collected from the *Calepino dell'azionista*. As a matter of fact, if performance or balance sheet data affect corporate organization-governance, data one and two years before the report seem to be the most relevant pieces of information. We consider the following performance indicators: market value-to-book value (MVBV), roe (ROE), Tobin's Q (QTOBIN). Size is measured in different ways: as the logarithm of the book value (LBOOK), as the logarithm of the market capitalization (LMKT), as the logarithm of sales (LMEDFAT). From the balance sheet we get some pieces of information that may be relevant in our analysis: the fraction of the value of shareholdings in other companies over the book value (PARTB), leverage given by the ratio of total debt over the book value (LEV), the growth rate of the book value (RBOOK).

## 5 Empirical Analysis

In this Section we provide an empirical analysis on the relation between company features, ownership structure and performance and governance mechanisms. We analyze some governance features of listed companies, we classify them in four main groups: board of directors composition (Section 5.1), board of directors internal organization (Section 5.2), board of auditors (Section 5.3), flow of information to the market (Section 5.4).

Facing a model selection problem we proceed as follows. We use control variables for size and then we look for effects associated with qualitative features of a company, we include a performance-evaluation measure, then we proceed to consider ownership structure and balance sheet information. We want to escape the endogeneity problem associated with our analysis. Being the rules introduced by the code of best practice in large part a novelty for Italian companies, we guess that corporate governance in 2002 is mainly determined by balance sheet data in 2000 – 2001 and ownership structure in 2001.

The analysis provided below has three main goals:

- 1) analysis of corporate governance determinants in a system with concentrated ownership;
- 2) evaluation of effectiveness of the new regulation on corporate governance and shareholders' rights;
- 3) evaluation of convergence of the governance of Italian companies towards effective governance mechanisms. The discussion provided in Section 2 and 4 has shown that by the end of the last century Italian companies did not care of internal corporate governance and in particular of the mechanisms introduced at that time by the Preda code of best practice. The degree of compliance in 2002 (considering 2001 as a transient status) can be considered a good picture to evaluate convergence of the Italian system. Determinants of governance features allow us to evaluate driving–impeding forces of convergence.

In Table 3 we present some data on the compliance of companies with the code of best practice and on shareholders' rights. The rate of compliance is not high on some crucial top-

ics, such as information on delegated powers and definition of powers of the board of directors on deals with related parties. In few cases the chairman is independent. Appointment of directors of the board is often opaque and in few cases the voto di lista is introduced to allow a representation by minority shareholders. While the establishment of an appointment committee is a rare event, a remuneration and an internal control committee are established in a large fraction of companies. Only one over two companies state that remuneration is related to the economic performance of the company. In case the voto di lista is introduced, the threshold to present a list is high, also the average threshold to present a list for the board of auditors is high.

Governance feature	all the market	MIB30
information on board meeting is provided	91%	97%
information on CEO delegated powers is provided	35%	46%
delegated powers defined by topic	42%	59%
delegated powers with an upperbound money limit	26%	31%
exclusive powers of the board of directors are defined	78%	83%
deals with related counterparts are approved ex ante by the board	51%	48%
supervise on conflict of interests ex ante	47%	38%
information on powers delegated to the chairman	26%	38%
the chairman is also a CEO	19%	14%
independent chairman	6%	14%
the chairman provides information before board meetings	69%	76%
information on independent directors is provided	97%	100%
procedure to handle private information is provided	84%	90%
voto di lista is introduced	14%	34%
information on candidate directors is provided	56%	55%
appointment committee	9%	10%
remuneration committee	65%	93%
remuneration is related to company performance	54%	66%
auditing committee	71%	83%
investor relator	81%	90%
three members in the board of auditors	93%	72%
Average size of the board	10	15
Average fraction of independent directors	42%	51%
threshold to present a list for the board of directors	2	1,7
threshold to present a list for the board of auditors	2,8	2

Table 3: Descriptive data.

## 5.1 Board of directors composition and selection

We handle three main topics: board size, fraction of independent directors, appointment of directors.

### Board size

While there is a large literature establishing a negative relationship between board size and firm performance, see [Hermalin and Weisbach, 2001, Yermack, 1996], the literature on the determinants of board size is not so large. [Denis and Sarin, 1999] show that the board size is positively related to the log of the market value of equity and to leverage, is negatively affected by growth opportunities and is unrelated to ownership of officers. [Barontini and Caprio, 2002] have analyzed board size of companies listed in the Italian

market in the period 1976 – 1996. They observe that the board is large in companies controlled by the State and in companies with a large size, the stake detained by the first shareholder negatively affects the size of the board.

In Table 4 we analyze the board size. We present results using as control variable for the size of the company the logarithm of the book value, similar results are obtained using as control variable the logarithm of the market value or the logarithm of sales. The size of the board is increasing in the market capitalization of the company. Banks and insurance companies are characterized by a board larger than other companies. Ipo and companies listing also in UK and in US are characterized by a smaller board. These firm specific features of the board size are confirmed in all specifications. Holding companies, i.e., companies classified by the Italian stock exchange as detaining participations in other companies with no industrial-commercial activity, are characterized by a small board (statistical significativity is established only in some specifications). On the other hand, companies belonging to a pyramidal group do not present specific features.

Companies with a high market to book value ratio are characterized by a small board.

As far the shareholders' composition is concerned, the board size is decreasing and then increasing in the first shareholder-coalition's stake, i.e., the board is large when the first shareholder owns a small stake and when he owns a large stake. The minimum point of the parabolic specification is around 70%. The board is also large when the percentage of the capital detained by shareholders with a stake smaller than 2% is large and when the stake detained by shareholders above 2% not controlling the company is large.

As far as institutional investors' shareholding is concerned, considering the stake detained by all institutional investors (including banks, foundations, insurance companies, investment and pension funds) we observe that the board size is increasing in it, statistical significance is established only in some regressions, in the other cases statistical significance is borderline, the result is confirmed considering only the investment funds' stake but it is not statistically significant. Considering control dummies, we observe that companies controlled by absolute majority have a small board, while non controlled companies have a large board.

A large board has been associated with a bad performance-evaluation, a relation confirmed above. The rationale is that a small board works better than a large board, a limited number of sits works as a governance device. In our analysis we have shown that companies controlled by an owner have a small board, banks and insurance companies have large boards as well as non controlled companies. On the other hand institutional investors, blockholders and small shareholders do not succeed to limit the size of the board. The interpretation is that blockholders may collude informally asking to be represented inside the board and in general that when there is no shareholder controlling the company there is a relaxation of efficiency in the board.

#### **Fraction of Independent Directors**

The empirical analysis on the fraction of independent directors build on various models-equations, results are reported in Table 5 and Table 6. The analysis shows that ownership structure and some company features affect the fraction of independent directors inside the board. Recall that according to the Preda code, independency refers to independency from large shareholders, company and managers. There is a small literature on the determinants of

variable	NUMAM	NUMAM	NUMAM	NUMAM	NUMAM	NUMAM	NUMAM	NUMAM	NUMAM
c	-3.27**	-2.9	-3.6**	-6.8***	-3.5	-4.4***	-5.2***	-5.4***	-6.23***
lmkt	1.25***	1.2***	1.26***	1.2***	1.25***	1.23***	1.2***	1.25***	1.27***
lbook									
privat									
ipo	-1.25***	-1.23***	-1.2***	-1.29***	-1.23***	-1.28***	-1.23***	-1.2***	-1.22***
ban	2.73***	2.7***	3***	3***	3***	3.2***	3.7***	3.58***	2.98***
ass	2.67***	2.6***	2.97***	2.78***	2.96***	2.6***	3***	2.95***	2.8***
pubut									
finpar	-1.18	-1.15	-1.14	-1.26*	-1.17	-1.5*	-1.17	-1	-1.26*
pira	0.42	0.43	0.46	0.33	0.43	0.25	-0.09	-0.05	0.37
dual	-2.7**	-2.65**	-2.5**	-2.6**	-2.7**	-2.72**	-2.63*	-2.63**	-2.87***
mvbv	-0.21***	-0.21***	-0.2***	-0.22***	-0.21***	-0.21***	-0.2***	-0.21***	-0.21***
roe									
qtobin									
lev1									
rbook									
immtb									
partb									
primaz	-0.08***	-0.08**	-0.08***		-0.08**				
azdue	0.01		0.02	0.04***	0.02				
mer		3.8e <sup>-3</sup>		0.04***					
primaz <sup>2</sup>	5.6e <sup>-4*</sup>	5e <sup>-4*</sup>	5.8e <sup>-4*</sup>		5.6e <sup>-4*</sup>				
istit	0.02	0.02*		0.02*		0.01	0.01	0.02	0.01
fondi			0.03						
persgr					7.4e <sup>-3</sup>				
banass									
contrdir						-1.46***			
contrfa							0.5		
contrfam									
contrsin								0.77	
noncontr									1.83***
contrsta									
ownman									
down									
percpre									
percman									
R <sup>2</sup> adjusted	56%	55.9%	55.7%	56.2%	55.6%	56%	53.5%	53.5%	55.4%
F statistic	27.5	27.4	27.2	30	27.1	32.9	29.7	29.7	32.2
num obs	251	251	251	251	251	251	251	251	251

Table 4: Board size. One star denotes 90% significance, two stars 95% significance, three stars 99% significance.

the percentage of outside directors in the US market. [Agrawal and Knoeber, 1998] analyzing a dataset of the 500 largest US firms show that the CEO being a founder negatively affects the percentage of board outsiders, other features of the company (insider shareholding, institutional shareholding, blockholding, leverage, firm size) do not affect the percentage of outside directors. [Denis and Sarin, 1999] show that the percentage of outside directors is positively affected by the log of the market value of equity, by the leverage ratio and negatively by ownership of directors and growth opportunities (measured by the industry's median market-book ratio). [Kaplan and Minton, 1994] show that appointment of outside directors (defined as people previously employed by banks or other non-financial corporations) increases following poor stock performance and earning losses. [Hermalin and Weisbach, 1988] show that poor firm performance increases the likelihood that inside directors leave and that outside directors join the board. Such appointments are more likely in firms with significant bank borrowings and concentrated ownership. [Adams and Ferreira, 2003] show that the percentage of outside directors increases when the CEO is also the chairman of the board and that a nonlinear relation holds between the percentage of independent directors and insider shareholding: as insider's shareholding increases, the percentage of outside directors first decreases and then increases.

In our analysis we observe that company size, measured as the log of the market capitalization, the log of sales or of the book value, positively affects the percentage of independent directors. The effect is only in part statistically significant. Probably the effect of size is obscured by the dummy variable associated with privatized companies, excluding this variable the logarithm of the market value or of the book value turns out to be significant. Privatized companies are characterized by a large fraction of independent directors.

Some company features are relevant. Banks and insurance companies are characterized by a large percentage of independent directors. The reason for this result is that the controlling shareholder of these companies is not a family but another institution-company. Moreover, the definition of independent directors is not so tight, it happens that the chairman or the CEO of a large bank controlling another bank is an independent director of the controlled bank. Companies belonging to a pyramidal group, i.e., controlled by another company, are characterized by a lower percentage of independent directors. This result is observed in all the regressions and sounds as a negative result, as a matter of fact companies belonging to a pyramidal group have more governance problems (higher risk of expropriation by the controlling company, conflicts of interests) and therefore more independent directors are expected. Dummy variables associated with other sectors, holding companies, companies listed in UK and US are not statistically significant. The fraction of independent directors is positively affected by the chairman of the board being independent, but not by the size of the board.

Other governance devices are associated with the percentage of independent directors. We cannot assess causality, however when *voto di lista* is adopted to appoint directors we observe a higher percentage of independent directors, moreover the percentage of independent directors is increasing in the number of committees internal to the board of directors (0, 1 or 2). The first result seems to establish that the *voto di lista* either allows minority shareholders to appoint independent directors or induces the large shareholder-owner to appoint

independent directors. The second result can be interpreted as follows: being the board of directors organized with internal committees, a large fraction of independent directors is needed to allow the board and the committees to work properly.

Ownership structure affects the fraction of independent directors in a significant way. The percentage of independent directors is first decreasing and then increasing in the stake detained by the first shareholder-coalition. Therefore the percentage of independent directors is large when the first shareholder has a small stake or a very large stake (he is in control of the company). It is interesting to note that the result is similar to that obtained in [Adams and Ferreira, 2003] analyzing the relationship between the percentage of outside directors and inside shareholding. While a *U*-shaped pattern with respect to inside shareholding in US is interpreted as an endogenous balance to misalignment of managers' incentives with respect to those of shareholders, in our setting the *U*-shaped pattern can be interpreted as a deliberate choice of the owner: when his stake is large, he allows outsiders inside the board, when his stake is not too high his control of the company is not strong and therefore he does not allow outsiders inside the board, finally when the percentage of the first shareholder is small there is no owner in many cases and there are more outside directors. The minimum point of the quadratic function varies depending on the regression between 30% and 60%. Significantly, the sensitivity of the fraction of independent directors to the stake of the largest shareholder is negatively affected by the manager or the chairman being the largest shareholder. Companies controlled by a coalition are characterized by a low fraction of independent directors and its sensitivity to the stake of the largest shareholder is positively affected by the presence of a coalition controlling the company.

The fraction of independent directors decreases in the stake of blockholders (shareholders with more than 2% of shares not controlling the company), and increases in the stake detained by small shareholders. The stake detained by institutional investors as a whole (investment and pension funds, foundations, banks and insurance companies) does not affect the percentage of independent directors, while the stake detained by investment funds above 2% (but not in the stake detained by all the Italian investment funds) has a positive effect, significative in some specifications.

If the company is controlled by the State there are more independent directors, but the effect is often obscured by the dummy variable associated with privatized companies, on the other hand a company controlled by a foreigner investor is not characterized by a higher percentage of independent directors.

As far as the economic performance is concerned, we observe that companies characterized by high market valuation or by high growth opportunities (those with a high market value to book value ratio) are also characterized by a smaller percentage of independent directors. Companies with a high leverage ratio or with a high ratio of shareholding in other companies over the book value are characterized by a small percentage of outside directors. So, leveraged firms and companies detaining a large fraction of shareholding in other companies do not allow independent monitoring. Note that these companies have more governance problems and are more exposed to pursue non shareholder value maximization goals. The rationale is that the owner of a leveraged company prefers not to have interference on the management of the company and so he does not allow independent directors inside the board. The result on

the shares detained in other companies is interesting: companies detaining a large quota of their book value in other companies are more opaque in terms of conflicts of interest, either they are on the top of a pyramidal group or they are engaged in cross-holding. In both cases, the management is less focused on shareholder value and the expropriation risk for minority shareholders is high; in this context the owner does not allow independent directors inside the board.

dep-indep var	PERCIND	PERCIND	PERCIND	PERCIND	PERCIND	PERCIND	PERCIND	PERCIND
c	0.46***	0.22**	0.27**	0.49***	0.49***	0.46***	0.37***	0.42***
lmkt			0.01	0.008				
lbook	0.01	0.01*			0.01	0.01	0.02***	0.009
privat	0.18***	0.17***	0.19***	0.2***	0.14***	0.17***		0.18***
ipo								
ban	0.19***	0.17***	0.17***	0.19***	0.2***	0.19***	0.19***	0.2***
ass	0.17**	0.17**	0.17**	0.17**	0.18***	0.16***	0.15***	0.17***
pubut								
finpar								
pira	-0.06**	-0.06**	-0.05*	-0.05*	-0.06**	-0.06**	-0.06**	-0.05**
dual								
lista					0.07*			
numco								0.07***
mvbv	-0.005	-0.005	-0.007*	-0.008*	-0.006	-0.005	-0.004	-0.007*
roe								
qtobin								
lev								
rbook								
immtb								
partb								
primaz	-0.006***	-0.004***	-0.005*	-0.006***	-0.005***	-0.005**	-0.006**	-0.006***
azdue	-0.003***			-0.003***	-0.002***	-0.003***	-0.003**	-0.003***
mer		0.002**	0.002*					
primaz <sup>2</sup>	5.4 <sup>-5</sup> **	6.7e <sup>-5</sup> ***	7.06e <sup>-5</sup> ***	5.7e <sup>-5</sup> **	5.5e <sup>-5</sup> ***	4.9e <sup>-5</sup> **	5.8e <sup>-5</sup> ***	5.8e <sup>-5</sup> ***
istit						-8.7e <sup>-5</sup>		
fondi	0.004*	0.004*	0.004*	0.004*	0.004*		0.002	0.003*
banass								
contrdir								
contrfa								
contrfam								
contrsin	-0.64***			-0.64***	-0.61***	-0.6***	-0.58***	-0.59***
noncontr								
ownman								
ownpre								
down								
contrsta							0.12**	
contrest							-0.1*	
primaz*down	-0.0009*	-0.0009*	-0.0009*	-0.0009*	-0.0007*	-0.001**	-0.001**	-0.0009*
primaz*contrsin	0.009***			0.009***	0.008***	0.009***	0.008**	0.008**
R <sup>2</sup> (adjusted)	39.2%	36.1%	36%	39.3%	39.9%	38.4%	37.2%	41.6%
Fstatistic	13.4	13.8	13	12.7	12.8	13	11.6	13.7
num obs	251	251	236	236	251	251	251	251

Table 5: Fraction of independent directors

### Appointment of Directors: Voto di Lista and information on candidates

The law on privatization required privatized companies to introduce the voto di lista mechanism in their by-laws, i.e., shareholders holding a stake above a certain threshold of shares may present a list to appoint directors. This mechanism allows to appoint directors



dep-indep var	PERCIND	PERCIND	PERCIND	PERCIND	PERCIND	PERCIND
c	0.43***	0.48***	0.46***	0.37***	0.3***	0.33***
lmkt		0.004*	0.01	0.007	0.03***	0.02***
lbook	0.01		0.17***	0.17***	0.15***	0.2***
privat	0.16***	0.18***				
ipo			0.19***			
ban	0.17***	0.17***	0.16**			
ass	0.14**	0.15**				
pubut						
finpar						
pira	-0.06**	-0.06**	-0.06**	-0.05*	-0.06**	-0.06**
dual						
presind	0.12**					
numam		0.006				
mvbv	-0.005	-0.005	-0.006	-0.002	-0.007*	-0.008*
roe						
qtobin						
lev				-0.01*		
rbook						
immtb						-0.03**
partb					-0.07*	
primaz	-0.005**	-0.005**	-0.006**	-0.0001	-0.001*	-0.001
azdue	-0.003***	-0.003***	-0.003***	-0.002*	-0.004***	-0.004***
mer						
primaz <sup>2</sup>	5.1-5**	5e-5**	5.3e-5**			
istit						
fondi	0.004*	0.003*	0.002	0.004**	0.002	0.003
sgr						
banass						
contrdir						
contrfa						
contrfam						
contrsin	-0.57***	-0.7***	-0.65***	-0.39*	-0.78***	-0.75***
noncontr						
ownman						
ownpre						
down						
contrsta						
contrest						
primaz*down	-0.0008*	-0.0008*	-0.0009**	-0.0004	-0.002***	-0.002***
primaz*contrsin	0.008**	0.009***	0.009***	0.0005	0.01***	0.01***
<i>R</i> <sup>2</sup> (adjusted)	40.5%	39.5%	38.9%	14.7%	30.5%	31.5%
<i>F</i> statistic	13.2	12.6	13.2	4.2	11	11.5
num obs	251	251	251	205	251	251

Table 6: Fraction of independent directors

who represent minority shareholders-blockholders rather than independent directors. Only 38 companies (14%) have adopted the voto di lista.

In Table 7 we present results on a probit regression considering as endogenous variable the dummy variable LISTA taking value equal to one if the company has adopted the voto di lista and zero otherwise. We do not consider neither the threshold to present the list nor the procedure to allocate directors when more than one list has been voted in the general shareholder meeting. However, the average threshold is high (2%) and only in seven companies we have that the voto di lista is applied on a pure proportional basis, in the other cases the absolute majority of directors is selected from the most voted list.

As expected, dummy variables associated with privatized companies and companies controlled by the State positively affect the probability that the company adopts the voto di lista. Financial companies (bank and insurance companies) have a lower probability of adopting the voto di lista, in particular no insurance company has adopted the voto di lista mechanism to select directors. Moreover note that no holding company (companies on the top of a pyramidal group) has adopted the voto di lista mechanism to appoint directors.

Ownership structure affects the probability of adopting the voto di lista mechanism. The probability is decreasing in the stake detained by the largest shareholder/coalition controlling the company. We have checked for a nonlinear relation (adding a quadratic term), but the term does not turn out to be statistically significant. The probability of adopting the voto di lista decreases in the stake detained by blockholders not controlling the company and is increasing in the stake detained by shareholders below 2%. The institutional investors' stake does not affect the probability that the company adopts the voto di lista to appoint directors, we present results only considering the stake detained by investment funds with a stake above 2%, but results do not change considering institutional investors as a whole or also investment funds with stakes even below 2%. Note the difference: when the largest shareholder holds a large stake he allows (appoints) independent directors but he does not introduce the voto di lista mechanism.

The probability of adopting voto di lista depends on the fact that the company is controlled or not. If the company is controlled by absolute majority or by a coalition then there is a low probability of having voto di lista to appoint directors, on the other hand if the company is controlled de facto or is not controlled we have a high probability for the voto di lista. However, only dummy variables associated with control by absolute majority and control de facto are statistically significant.

Independently of the method adopted to appoint directors, the code of best practice requires companies to provide information on candidates. In Table 8 we present probit regressions considering as endogenous variable INFORM which takes value equal to one when the company states in his corporate governance report that information about candidate directors is released (by presenting a short curriculum vitae) before the general shareholders meeting. Regressions establish that privatized and companies controlled by the State are characterized by more information on candidate directors, however the adoption of the voto di lista turns out to be the key reason for this effect, putting all the three variables in the regression only voto di lista turns out to be statistically significant.

Size and company evaluation do not affect the probability of releasing information on

dependent var	LISTA	LISTA	LISTA	LISTA	LISTA	LISTA	LISTA	LISTA
c	-0.8	0.05	-1.89**	3.66	-0.75	-0.99	-1.05	-1.24
lmkt								
lbook	0.01	-0.02	-0.01	-0.01	-0.008	-0.07	-0.02	-0.009
privat	1.24***	1.37***	1.34***	1.38***	1.3***	1.37***	1.32***	1.3***
ipo								
ban	-0.79*	-0.9**	-0.86**	-0.89**	-0.66	-0.33	-0.42	-0.6
ass	-7.58***	-7.8***	-7.59***	-7.57***	-8.2***	-7.93***	-6.8***	-7.3***
pubut								
finpar	-7.34***	-7***	-6.85***	-6.85***	-7.6***	-7.82***	-6.6***	-6.9***
mvbv	0.03	0.02	0.02	0.02	0.03	0.04	0.04	0.03
roe								
qtobin								
lev								
immtb								
partb								
rbook								
primaz	-0.01**	-0.02***		-0.06*				
azdue		-0.02**		-0.06*	-0.02*	-0.02	-0.01	-0.01
mer			0.02***	-0.04				
istit								
fondi	-0.03	-0.02	-0.02	-0.02	-0.02	-0.02	-0.02	-0.02
banass								
contrdir					-0.66**			
contrfa						0.67**		
contrfam								
contrsin							-0.23	
noncontr								0.47
contrsta	1.19***	1.27***	1.24***	1.27***	1.25***	1.05**	1.09**	1.22***
ownman								
down								
McFadden $R^2$	30%	32.6%	31.6%	33.3%	31%	30%	28%	28.7%
num obs	251	251	251	251	251	251	251	251

Table 7: Voto di Lista.

candidate directors. As far as ownership structure is concerned, we observe that as expected the probability of having information on candidates decreases in the stake of the first shareholder, but surprisingly it decreases also in the stake of blockholders. The interpretation is that when shareholders owning a stake above 2% represent a large fraction of the capital the large shareholder does not allow transparency on candidate directors or that blockholders collude with the largest-controlling shareholder. On the other hand, the probability of having information on candidates before the shareholders meeting increases in the fraction of the capital detained by small shareholders.

Companies explicitly define in many cases a threshold in terms of fraction of the board needed to convene the board (PERCONV). Regressing this threshold on explanatory variables we do not get much information. Curiously enough the only variable that comes out to be statistically significant turns out to be the dummy variable associated with the voto di lista: a company that adopts the voto di lista to appoint directors tends to have a high threshold for convening the board. Voto di lista introduces the threat of having directors representing minority shareholders, then the large shareholder addresses this threat by increasing the fraction of directors of the board necessary to convene board meetings. Also leveraged firms have a high percentage for convening the board.

#### **The chairman of the board of directors**

In many corporate governance studies on UK and US financial markets, one of the key point is the role of the chairman. In particular, independency and separation between chairman and CEO are considered to be good corporate governance features.

We address this point in our analysis considering four dummy variables: PRESAM assuming value equal to 1 when the chairman is also a CEO and zero otherwise, PRESIND assuming value equal to one when the chairman is independent and zero otherwise, OWNPRE assuming value equal to one when the chairman of the board of directors is also the shareholder controlling the company, OWNMAN assuming value equal to one when a CEO is also the shareholder controlling the company. Results for probit regressions on these dummy variables are presented in Table 9.

As far as the chairman being independent is concerned, we observe some obvious facts: companies controlled by the State, banks and insurance companies are more likely to have an independent chairman. Companies controlled (either by absolute majority, de facto or by a coalition) are less likely to have an independent chairman of the board. It is also interesting to note that there is no holding company with a independent chairman. What is surprising is that the stake detained by investment funds either has a negative but insignificant effect on the probability of having an independent chairman (in the case of investment funds with a stake above 2%) or the effect is negative and statistically significant (considering the stake detained by all investment funds). A similar conclusion can be drawn on the effect of blockholders, the effect is negative, and its significativity depends on the specification of the model.

We are not going to present estimates on any model for PRESAM because we have not been able to find out a good specification, it only turns out that the probability of the chairman being also a CEO is negatively affected by the size of the company and positively by the fact that the company is controlled. All other variables do not turn out to be significant.

dependent variable	INFORM	INFORM	INFORM	INFORM	INFORM	PERCONV	PERCONV	PERCONV
	0.83	0.56	0.47	-0.4	-0.6	0.38***	0.37***	0.38***
lnkt	0.002	0.03	0.01	0.02	0.02	0.007	0.007	0.007
lbook	0.59*							
privat	0.46**	0.46**	0.43**	0.43**	0.43**	-0.01	-0.01	-0.02
ipo	-0.9***	-0.82***	-0.74**	-0.73**	-0.74**	0.001	0.0005	
ban								
ass								
pubut								
finpar	-0.69*	-0.72*	-0.65*	-0.66*	-0.67*			
pira								
lista			0.98***	0.99***	1***	0.05*	0.05*	0.04*
numam						-0.01***	-0.01***	-0.01***
mvbv	-0.03	-0.02	-0.03	-0.03	-0.03	-0.004	-0.004	-0.004
roe								
qtobin								0.01*
lev								
primaz	-0.01**	-0.01**	-0.009*		-0.002	-0.0004	-0.0002	-0.0002
azdue	-0.01**	-0.01**	-0.01*	-0.004	0.008*	0.01	0.0002	-6.2 <sup>-5</sup>
mer						-3.02 <sup>-5</sup>		
istit								
fondi	0.01	0.004	0.01	0.01	0.01	-0.0005	-0.0004	-0.001
banass								
contrdir								
contrfa								
contrfam								
contrsin								
noncontr								
contrsta		0.62*						
ownman								
ownpre								
down								
percre								
McFadden R <sup>2</sup>	8.3%	8%	10.5%	10.4%	10.3%	9.7%	9.8%	11.1%
num obs	251	251	251	251	251	202	202	160

Table 8: Information on candidate directors

Regressions considering as endogenous variables the chairman being the controlling shareholder or the CEO being the controlling shareholder show some obvious facts: banks and insurance companies are less likely to have the owner of the company as chairman of the board or as CEO. Interestingly, once we control for the company being controlled by a shareholder or by a coalition (DCONTR), these variables are not affected by the fraction of the capital detained by the controlling shareholder(s), small shareholders, blockholders, investment funds. The stake detained by the first shareholder interacted with DCONTR does affect positively the probability of observing the controlling shareholder as chairman of the board or as CEO. It is interesting to observe that the largest shareholder is not interested in being the chairman or a CEO of a company belonging to its pyramidal group, while he is interested in being the chairman of the company at the top of the pyramidal group.

	PRESIND	PRESIND	PRESIND	OWNPRE	OWNMAN	OWNPRE	OWNMAN	INFOPRE
c	0.34	0.26	-0.08	-0.3	0.003	-0.45	0.65	-0.52
lmkt								
lbook	-0.05	-0.05	0.001	-0.04	-0.09	-0.03	-0.08	-0.005
privat								
ipo				0.57***	0.2	0.57***	0.23	
ban	1.1***	1.11***	1.1**	-1.02***	-0.9**	-1.15***	-0.98**	
ass	1.38**	1.27**	1.41**	-1.24**	-0.98*	-1.36**	-1.03*	
pubut								
finpar	-6.5***	-6.8***	-7.5***	1.47***	0.26	1.3***	0.25	
pira				-0.43*	-0.39*	-0.26	-0.28	-0.29
lista								
numam								0.06*
mvbv	-0.03			0.02	0.02	0.02	0.02	0.004
roe								
qtobin								
lev								
primaz								0.008*
azdue	-0.02	-0.03*	-0.02	0.009	0.006	0.009	-0.002	0.01*
mer	-0.01	-0.01	-0.01	-0.006	0.005			
istit								
fondi	-0.08			-0.03	-0.02	-0.02	-0.02	0.008
sgr			-0.12*					
banass								
contrdir								
contrfa								
contrfam								
contrsin								
noncontr								
contrsta	1.21**	1.13**	1.2**	-9.4***	-8.6***	-8.89***	-8.6***	7.7***
ownman								
ownpre								
down								
dcontr	-1.16**	-1.16**	-1.18**	1.5***	1.06***			
primaz*dcontr						0.02***	0.005	
McFaddenR <sup>2</sup>	23.5%	21.6%	26.3%	29.7%	16.6%	26.3%	14.2%	8%
num obs	251	253	253	250	236	250	236	250

Table 9: Chairman of the board of directors and CEO

A difficult but very important point to handle is the transmission of information to the board. According to the code, the chairman should transmit all relevant information to the board before the meeting. On this point, reports are not very reliable. Statements are quite elusive on the point. We have run a regression on the fact that the chairman is committed

to provide all relevant information to the board. In Table 9 it is shown almost no variable turns out to be significant, the probability of having a good flow of information to the board of directors is increasing in the board size and in the stake of the largest-controlling shareholder and in the stake of blockholders. All the companies controlled by the State are characterized by a good flow of information.

## 5.2 Board of directors internal organization

As far board of directors internal organization is concerned, the code of best practice concentrates on three main topics: internal committees, delegated powers, flow of information inside the company.

Excluding the executive committee, there is almost no tradition for internal committees in Italian companies. The executive committee is used in many companies as a committee to which the board delegates well defined administrative powers. Following the UK-US experience, the Preda committee suggests the adoption of a control committee, remuneration committee, appointment committee.

### Internal control committee

variable	COMCON	COMCON	COMCON	COMCON	COMCON	COMCON	COMCON	COMCON
c	-1.18	-2.2**	-1.3*	-1.4**	-1.5**	-1.53**	-2.8***	-2.2**
lmkt	0.19***	0.24***	0.17***	0.16**	0.17***	0.17***	0.23***	0.24***
lbook		0.75***					0.76***	0.76***
privat	-0.8***	-0.79**	-0.72**	-0.56**	-0.59**	-0.66**	-0.79**	-0.78**
ipo		6.8***					7.3***	
ban					8***	7.1***		
ass			7.45***	7.2***				7.4***
pubut								
dual								
mvtbv	0.07**	0.06*	0.08**	0.08**	0.08**	0.08**	0.06	0.06*
roe								
qtobin								
lev								
partb	-0.52*	-0.41	-0.46	-0.5	-0.46	-0.45	-0.4	-0.4
primaz	-0.01**	-0.01*						-0.007
azdue							0.002	
mer							0.008*	
istit								
fondi	-0.01	-0.01	-0.01	-0.01	-0.01	-0.01	-0.006	
percsgr								-0.001
banass								
contrdir			-0.36*					
contrfa				0.46*				
contrfam								
contrsin					-0.06			
noncontr						0.2		
contrsta								
ownman								
down								
McFaddenR <sup>2</sup>	7.7%	13.2%	8.3%	8.2%	7.1%	7.3%	13.3%	16.2%
num obs	251	251	251	251	251	251	251	251

Table 10: Internal control committee

In Table 10 we present probit regression with the dummy variable COMCON as en-

ogenous variable (taking value equal to one when there is an internal committee and zero otherwise). As expected, large companies are characterized by a higher probability than smaller companies of adopting an internal control committee. The results concern the book value, similar results hold true for the market capitalization and sales.

Banks are under the supervision of the Bank of Italy and therefore they comply with other systems of internal control which do not include the internal control committee. All companies listed also in UK and US have introduced an internal control committee, newly listed companies are also characterized by a higher probability of adopting an internal control committee.

As far as the ownership structure is concerned, we observe that the probability of adopting an internal control committee is decreasing in the stake detained by the largest shareholder, we checked for nonlinearity in this relation but we have not found any evidence. The stake detained by blockholders and the stake detained by investment funds do not affect the probability of adopting an internal control committee, only the stake detained by small shareholders has a positive effect on it. The probability of introducing an internal control committee depends on the fact that the company is controlled or not. If the company is controlled by absolute majority or by a coalition then there is a low probability of observing the presence of an internal control committee, on the other hand if the company is controlled de facto or is not controlled we have a high probability for observing it. However, only dummy variables associated with control by absolute majority and control de facto turn out to be statistically significant.

Companies with a high valuation tends to introduce the internal control committee. An interesting result is provided by the dependence on the fraction of shareholding in other companies over the book value. The sign is negative. The coefficient is statistically significant only in some regressions, in the other cases significativity is next to 10%. Companies with a large fraction of shareholding in other companies are characterized by more governance problems and therefore an internal control committee is expected.

In Table 11 we restrict our attention to non financial companies considering leverage as a determinant of the decision to introduce an internal control committee. [Deli and Gillan, 2000] have shown that the demand for a fully independent and active audit committee by US companies is positively related to the demand for accounting certification, the likelihood of a firm having a completely independent and active audit committee being negatively related to firm growth opportunities and managerial ownership and positively related to firm size and leverage. Results on ownership structure shown in Table 10 are confirmed: the probability of adopting an internal control committee is negatively affected by the stake of the largest shareholder and is not affected by the stake of investment funds and of large blockholders. Results on control type dependence are not shown, they are similar to those presented in Table 10. Interesting enough, the result of leverage is the opposite to the one observed in US: companies with a high leverage ratio have a lower probability of introducing an internal control committee.

In Table 11 we also analyze the probability of having a fully independent internal control committee. For this type of regressions we restrict our attention to the subsample of companies that have introduced an internal control committee. We are left with 141 companies.



Again the result is striking, while the probability of observing a fully independent internal control committee does not depend on the stake of the largest shareholder, on the stake detained by investment funds and by the market; the stake detained by large blockholders have a negative effect on it.

The choice to have fully independent internal control committee seems to be a good choice for a large shareholder who is in full control of the company. The last two regressions confirms this interpretation: companies controlled by absolute majority (de facto) are characterized by a higher (lower) probability of having a fully independent internal control committee.

variable	COMCON	COMCON	COMCONI	COMCONI	COMCONI	COMCONI	COMCONI	CONTRINT
c	-2.9***	-3.6***	0.35	0.83	0.38	-0.14	0.14	-0.56
lmkt	0.35***	0.35***						
lbook			-0.05	-0.06	-0.05	-0.07	-0.04	0.2**
privat								
ipo								
ban			1.73***	1.77***	1.6***	1.55***	1.42**	
ass								7***
pubut								
pira			-0.38***	-0.38*	-0.33	-0.38*	-0.27	
dual	7.25***	7.15***	0.7	0.72	0.7	0.79	0.7	
mvbv	0.02	0.03	-0.03	-0.03	-0.03	-0.04	-0.04	-0.02
roe								
qtobin								
lev	-0.18**	-0.16**						
partb								
primaz	-0.01*		0.003					-0.01*
azdue		0.01		-0.02**				
mer					0.005	0.01**	0.009	
istit								
fondi	-0.01	-0.01	-0.02	0.003	-0.02	-0.001	0.008	-0.03
percsgr								
banass						0.73***		
contrdir								
contrfa							-0.51*	
contrfam								
contrsin								
noncontr								
contrsta								
ownman								
down								
McFaddenR <sup>2</sup>	15.8%	15.1%	10.6%	12.9%	10.8%	14.7%	12.2%	10.3
num obs	190	190	141	141	141	141	141	236

Table 11: Internal control committee

In Table 11 we have also presented a regression on the adoption of an internal control system. The probability of adopting an internal control system decreases in the stake detained by the first shareholder; blockholders and investment funds' stakes do not affect it. We do not present regressions considering dummy variables on the control type, results are similar to those obtained in Table 10: if the company is controlled by absolute majority then there is a low probability of observing the presence of an internal control system; if the company is controlled de facto, then there is a high probability of observing it. The two dummy variables associated with control by absolute majority and control de facto are statistically significant.

### Remuneration committee

As far as the remuneration committee is concerned, the likelihood of adopting a remuneration committee increases in the capitalization of the company and decreases in the stake of the first shareholder. It increases in the stake of blockholders and of small shareholders, no effect is associated with the stake of institutional investors. Companies controlled by absolute majority have a low probability of adopting a remuneration committee, on the other hand companies controlled de facto have a higher probability of adopting a remuneration committee. Probability increases if top executive directors have part of their remuneration contingent upon the performance of the company.

dependent variable	COMRE -3.2***	COMRE -3.34***	COMRE -3.3***	COMRE -3.4***	COMRE -3***	COMRE -2.7***
lmkt						
lbook	0.29***	0.27***	0.27***	0.28***	0.28***	0.28***
privat						
ipo	0.55***	0.57***	0.58***	0.57***	0.55***	0.55***
ban	-0.44	-0.23	-0.27	-0.41	-0.5	-0.49
ass	-1.25**	-1.19**	-1.1**	-1.13**	-1.17**	-1.18**
pubut						
finpar						
ammpre	0.39**	0.43**	0.43**	0.40**	0.37**	0.37**
mvbv	0.06*	0.06*	0.06*	0.06*	0.06*	0.06*
roe						
qtobin						
lev						
primaz					-0.009*	0.01
azdue					0.004	
mer						-0.002
istit						
fondi	0.003	0.003	0.004	0.004	0.001	0.002
banass						
contrdir	-0.44**					
contrfa		0.5**				
contrfam						
contrsin			-0.19			
noncontr				0.33		
contrsta						
ownman						
down						
perpre						
McFadden R <sup>2</sup>	13.9%	13.6%	12.3%	12.8%	13.8%	13.7%
num obs	250	250	250	250	250	250

Table 12: Remuneration committee

### Appointment committee

We are not going to present any result on the adoption of the appointment committee. The Preda report points out that the appointment committee is not a must. What we expect is that the appointment committee is adopted in companies not controlled by a shareholder or with many small shareholders-blockholders. These variables do not affect significantly the probability of observing an appointment committee, the only relevant variable is the dummy variable associated with newly listed companies. It seems that newly listed companies adopt an appointment committee only to appear à la page for their governance.

### Delegated powers

One of the main features of the code is the centrality of the board of directors in the management of the company. The board of directors plays a central role in taking strategic decisions, it is admitted that the board delegates to executive directors some powers maintaining some exclusive powers and defining properly delegated powers. In Table 13 we present a probit analysis on the presence of limits to delegated powers and of powers-decisions that are retained as exclusive of the board of directors.

As far as limits to delegated powers we observe that delegated powers are well defined in large companies and in companies under strict control (companies controlled by absolute majority). Blockholders and small shareholders succeeds to impose well defined delegated powers, the probability of having well defined delegated powers increases in their stakes. It seems that when there is an owner he is able to impose well defined limits to delegated powers. The probability of having well defined powers increases when the CEO is also the controlling shareholder of the company. Institutional investors do not affect the probability of observing well defined delegated powers. Companies characterized by a large ratio of shareholdings over the book value do not have well defined delegated powers.

dependent var c	LIMDEL -4.5***	LIMDEL -2.95**	LIMDEL -4.4***	ESCLU 1	ESCLU 0.57	ESCLU 0.86	ESCLU 0.8	ESCLU -0.38
lmkt	0.14	0.14	0.15*					
lbook				0.04	0.06	0.02	0.02	0.05
privat								
ipo				0.73	0.8	0.95*		0.8
ban								
ass								
pubut				1.07*	1.14*	0.47	0.69	1.1*
finpar								
numam								
mvbv	0.01	0.01	0.01	-0.05*	-0.04	-0.03	-0.02	-0.04*
roe								
qtobin								
partb	-1.8*	-1.6*	-1.87**	-0.9**	-0.87***			-0.87**
lev							-0.1*	
primaz				-0.005	-0.0001	0.001	0.002	0.01
azdue	0.04***	0.02*	0.04***	-0.01	-0.007	-0.005	-0.007	
mer	0.02**	0.01	0.02**					0.01
primaz <sup>2</sup>								
istit	0.01	0.01						
fondi			-0.002	-0.01	-0.01	-0.01	-0.01	-0.01
banass								
contrdir	1.09**		1.01**					
contrfa		-0.49						
contrfam								
contrsin								
noncontr								
contrsta								
ownman	0.53*	0.45	0.45	-0.32*				
ownpre								
down					-0.44**	-0.48**	-0.4*	-0.43**
percpre								
McFaddenR <sup>2</sup>	6.5%	5%	6%	9%	10.3%	7.4%	4.8%	10.8
num obs	221	221	221	251	251	251	205	251

Table 13: Delegated and Exclusive powers

Results on exclusive powers of the board contrast in part those obtained for delegated

powers. While the stakes detained by the largest shareholder, blockholders, small shareholders and investment funds do not affect the probability of having powers exclusive of the board, the probability is negatively affected by the CEO or the chairman being the controlling shareholder. Leveraged companies and companies with a large ratio of shareholdings over the book value are characterized by a lower probability of having powers exclusive of the board. The chairman of the board or the CEO being the controlling shareholder negatively affects the probability of having a board with exclusive powers.

The code of best practice explicitly handles deals-trades occurred under conflict of interests and deals involving related parties. The code recommends that the board of directors handles these deals and that conflicts of interests are avoided through appropriate procedures. We collected data on the fact that corporate governance reports refer to these topics (exclusive powers on deals with related parties and procedures to avoid conflicts of interest). We have not found a good specification for these two features of the governance and therefore we do not present any result.

### 5.3 Board of auditors

As far as the board of auditors is concerned, we concentrate on two main points: the size of the board (NUMSIN), the threshold allowing shareholders to present a list to appoint auditors (LISTASIN).

The TUF establishes that minority shareholders have the right to appoint members of the board of auditors by presenting a list to appoint 1 over 3 members or 2 over 5 members. The size of the board is important since the TUF has established that two auditors are enough to convene the board of directors and the general shareholders meeting. First of all note that the number of companies adopting in their by-laws a board of auditors made by five members is small, only 18 companies over 270 (7%) have a board of auditors with five effective members. The variable NUMSIN is a dummy variable assuming value equal to 0 when the board of auditors is made up of three effective members and value equal to 1 when there are more than three members.

It is interesting to note that all the companies with 5 effective members in the board of auditors are either banks, public utilities, privatized or controlled by the State companies, in these cases regulation requires large boards, and in many case the State has the right to directly appoint one member of the board. In Table 14 we report a probit regression having NUMSIN as endogenous variable. As no insurance and holding company has more than three effective members, dummy variables associated with these features turn out to be significative. Ipo companies are also characterised by a small board of auditors.

The TUF allows minority shareholders' representation inside the board of auditors, representation is guaranteed through the voto di lista mechanism. Then the crucial point becomes the threshold (percentage of shares) that allows shareholders to present a list. The average quorum to present a list is quite high, 2.8%.

In what follows we analyze the determinants of the percentage necessary to present a list. The analysis reported in Table 15 shows that privatized companies and banks are characterized by a small percentage to present a list, a good performance or good growth

dependent var c	NUMSIN -5.29***	NUMSIN -4.1***	NUMSIN -4.85***	NUMSIN -3.39**	NUMSIN -3.87***	NUMSIN -5.17*
lmkt	0.26**	0.18*	0.26***	0.18*	0.21**	0.37
lbook	1.04***	1.28***	1.46***	1.39***	1.28***	2.86***
privat		-1.04**	-1.28**	-1.07*	-1.09*	-3.15**
ipo	0.6*	0.58				
ban	-7.03***	-6.7***			-6.6***	
ass						
pubut	-6.92***	-6.6***			-7.02***	
finpar						
azrisp			-0.75*			
ammpre						
mvbv						
roe						
qtobin						
lev						-3.09**
partb						2.98
immtb						2.73**
primaz				-0.01*		
azdue						
mer						
istit						
fondi						
banass						
contrdir						
contrfa						
contrfam						
contrsin						
noncontr						
contrsta						
dcomtr					-0.8**	-4**
ownman						
down						
McFadden R <sup>2</sup>	36.3%	40.7%	39.1%	39.5%	42.5%	76.4%
num obs	253	253	253	253	253	206

Table 14: Board of auditors size

opportunities (proxied by a high value of the market value to book value ratio) induce the company to reduce the threshold. Ownership affects the threshold in an interesting way: the threshold to present a list decreases in the percentage detained by the largest shareholder and in the percentage detained by the market, on the other hand the percentage increases in the stake detained by shareholder above 2% who are not the first shareholder. The percentage of shares detained by blockholders affects the threshold by increasing it. The interpretation is that when the largest shareholder has a large stake he allows a low threshold, he fears only blockholders and therefore a large stake by blockholders induces the first shareholder to introduce a high threshold. Note that the stake of institutional investors (bank, insurance companies, foundations and investment funds) does not induce a lower threshold to present a list of board members. We have tested for nonlinearities with respect to the stake detained by the first shareholder with no result. Results are similar to those obtained for the percentage of independent directors (first increasing and then decreasing) but the nonlinear coefficient is not statistically significant.

As far as board of auditors candidates are concerned, information on candidates to become auditors should be released before the general shareholders meeting. We are not going to present any regression on this point because no model turns out to be statistically significant.

#### **5.4 Flow of information to the market**

The code of best practice and the internal dealing code handle the diffusion of information by the company.

The code of best practice recommends the company to introduce a procedure to handle price sensitive and confidential information. The dummy variable INFODIS assumes value equal to 1 when such a procedure is defined and zero otherwise. Companies with a large stake detained by the largest-controlling shareholder and with a large stake detained by blockholders have a lower probability of adopting such a procedure, instead the stake detained by small shareholders positively affects the likelihood. On the other hand, no model turns out to be significant for the decision to appoint an investor relator.

The internal dealing code establishes two thresholds for communicating to the Italian Stock Exchange information on trades by the top management of the company. Companies can cut the threshold. In Table 16 we show that the probability of having a threshold smaller than 1/2 the threshold established by the code is increasing in the stake detained by the largest-controlling shareholder and decreasing in the stake detained by blockholders. There are two contrasting facts: on one hand, the probability of a stringent threshold increases if the management of the company has a remuneration contingent upon performance, on the other the probability of a stringent threshold is low when the manager is also the owner of the company. Similar results are obtained for the dummy variable assuming value equal to one when there are blackwindow periods. Interestingly enough, companies controlled by other companies have high thresholds and do not adopt the blackwindow period.

variable	LISTASIN	LISTASIN	LISATSIN	LISTASIN	LISTASIN	LISTASIN
c	5.76**	3.3***	4.04***	3.98***	3.6***	3.35***
lmkt						
lbook	-0.1	-0.1	-0.17**	-0.17**	-0.15**	-0.13
privat	-1.21***	-1.22**		-1.3***	-1.3***	-2.2***
ipo						
ban	-0.88**	-0.88**	-0.99***			
ass						
pubut						
finpar						
pira	0.49**	0.45**	0.49**	0.5**	0.47**	0.61**
dual						
mvbv	0.09**	0.09**	0.08**	0.1***	0.11***	0.13***
roe						
qtobin						
lev						0.3**
rbook						
immtb					0.28**	
partb				0.56*		
primaz	-0.03***					
azdue		0.02***	0.02***	0.02***	0.02***	0.2**
mer	-0.02***					
primaz <sup>2</sup>						
istit						
fondi	0.008	0.009	0.017	0.008	0.01	0.002
banass						
contrdir						
contrfa						
contrfam						
contrsta	0.89*	0.86*	0.13	1.05**	0.92*	1.86***
contrsin	0.9**	0.95**	0.93**	0.89**	0.88**	1.11**
noncontr						
ownpre						
down						
percman						
presam						
R <sup>2</sup> (adjusted)	15.3%	15.1%	12.8%	13.9%	14.7%	14.7%
F statistic	5.5	5.9	5.6	5.48	5.8	4.9
num obs	251	251	251	251	251	205

Table 15: Threshold to present a lista for the board of auditors

variable	TRIME 1.55*	TRIME 1.1	TEMPE 2.1***	TEMPE 2**	INFODIS 1.3	INFODIS -0.26	BLACKDA -0.17
lmkt	-0.02	-0.009	-0.09*	-0.09*	0.04	0.04	0.04
lbook	-0.54*	-0.5	-0.3	-0.27	-0.17 7***	-0.18 6.9***	
privat							
ipo							
ban							
ass							
pubut							
finpar	0.46**	0.54**	0.12	0.08			-0.35*
pira	-0.41**	-0.39*	-0.15	-0.14			
ammpre							0.33*
remval							
mabv					0.01	0.005	-0.04
roe							
qtobin							
rbook							
lev							
primaz	-0.02***	-0.01*	-0.05**	-0.009*	-0.01**	0.003	0.02
azdue	0.01	0.02*	0.008	0.006	-0.01*	0.02*	-0.01
mer							
istit							
fondi	0.02	0.02	-0.01	-0.02	0.02	0.03	-0.01
banass							
contrdir							
contrfa							
contrfam							
contrsin							
noncontr							
contrsta							
ownman		0.65***					-0.54***
down				0.47**			
primaz*down	0.009**		0.009****				-0.01
McFadden R <sup>2</sup>	10.9%	11.5%	7.8%	7.2%	4.8%	5.3%	7.2%
down	246	232	248	248	251	251	230

Table 16: Internal control committee

	PRIMAZ	AZDUE	MER	FONDI	MVBV	LEV	PART	IPO	PIRA	FINPAR	DUAL
small board	+	-	-	-	+	-	-	+	-	-	-
indep directors	-	-	+	+	-	-	-	-	-	-	-
voto di lista	-	-	+	-	-	-	-	+	-	-	-
inform	-	-	+	-	-	-	-	+	-	-	-
presind	-	-	+	-	+	-	-	+	-	-	+
comcon	-	-	+	-	+	-	-	+	-	-	-
comconi	-	-	+	-	+	-	-	+	-	-	-
contrint	-	+	+	-	+	-	-	+	-	-	-
comre	-	+	+	-	+	-	-	+	-	-	-
limdel	-	+	+	-	+	-	-	+	-	-	-
esclu	-	-	-	-	-	-	-	-	-	+	-
numsin	-	-	-	-	-	-	-	-	-	-	-
listasin	+	-	+	-	-	-	-	-	-	-	-
partcom	+	+	-	-	-	-	-	-	-	-	-
trime	+	-	-	-	-	-	-	-	-	-	-
tempe	+	-	-	-	-	-	-	-	-	-	-
infodis	-	-	+	-	-	-	-	-	-	-	-
blackda	-	-	-	-	-	-	-	-	-	-	-

Table 17: Governance mechanisms



## 6 Conclusions

The analysis presented in this paper has shown some interesting results on the debate on corporate governance in Italy and in particular on its convergence towards a well functioning corporate governance system.

As far as corporate governance determinants are concerned, we have shown that governance features are affected by shareholders composition (stake detained by the largest-controlling shareholder, blockholders, small shareholders), balance sheet data and company features. It is difficult to evaluate effectiveness of the new regulation on financial markets and company organization. Compliance with the code of best practice may be a pure formal statement. We have shown that the rate of compliance is not large on some crucial topics, such as information on delegated powers and definition of powers of the board of directors on deals with related parties. In few cases the chairman is independent. Appointment of directors of the board is often opaque and in few cases the *voto di lista* is introduced to allow a representation by minority shareholders. While the establishment of an appointment committee is a rare event, a remuneration and an internal control committee are established in a large fraction of companies (50% – 70% of companies). In case the *voto di lista* is introduced the threshold to present a list is high, also the average threshold to present lists for the board of auditors is high. We guess that a governance device is effective if it is sensitive to some features of the company (if this is not the case and almost all companies comply or refuse to comply with it then probably it is meaningless). According to our analysis, the fraction of independent directors as well as the introduction of an internal control committee-system, establishment of the *voto di lista* to appoint directors and a low threshold to present a list to appoint auditors are effective mechanisms. Delegated powers, flow of information inside the company and outside the company are not regulated in an effective way.

In Table 17 we present the governance features analyzed in the empirical analysis and the effect of some exogenous variables, by + we mean that the exogenous variable has a positive effect by – we mean that the variable has a negative effect, no sign is reported when the coefficient is not statistically significant. The Table shows that while the effect of forces contrasting convergence (stake detained by the largest shareholder, companies belonging to a pyramidal group) work against convergence, those forces that should help convergence (monitoring by large blockholders, institutional investors' stake, debt) do not succeed to guarantee good governance devices. Only the stake of small shareholders positively affects some governance features. Companies at the top of a pyramidal group or with a large fraction of shareholding over the book value are characterized by poor governance. Companies listed in the last years are characterized by a good governance while companies listed in UK and in US do not have a better governance.

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