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Corporate Governance in Italian Listed Firms: An Overview

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Abstract

The paper provides an overview of the Italian corporate governance problem, which takes into account the key features of the ownership structure of domestic firms listed at the Milan Stock Exchange in 2004. Basically, it is argued that, although in recent years significant rules were issued to improve the Italian corporate governance system, effective and prompt reforms seem still urgent in the national research agenda.
The paper is divided as follows. In section 2, some evidence concerning the general ownership structure of Italian listed firms is provided. In this regard, recent data would confirm the concentration of ownership as the basic feature of Italian listed firms, with 32% as the mean share of the majority shareholder.
In section 3, some specific terms of the corporate governance problem for Italian listed firms are set. Basically, it is argued that the overall effectiveness of both external and internal controls might be, at some level, negatively influenced by the shareholders' meeting, more deeply by the majority shareholder. In this regard, some evidence from the traditional governance structure of listed joint-stock companies is shown.

1. Introduction

In recent years, corporate governance issues became prominent both in academic literature and in public policy debates. Indeed, while some of the questions on the topic arose since the seminal study by Berle and Means (1932), corporate governance was hardly considered an outstanding topic until the 80s. In the last two decades, however, its relevance was mostly increased by the following events (Becht, Bolton, Röell, 2002): the privatisation of firms in Latin America, Western Europe, Asia and Russia[1]; the number of mergers and hostile takeovers in the United States and Europe; the greater integration of the world capital markets, such as the European Union; the macro-economic crisis in Russia, East Asia and Brasil.

While these reasons justified the growing importance of corporate governance, the relevance of the topic was, as known, definitely grasped by a number of recent financial frauds (e.g. Enron, Worldcom, Cirio and Parmalat). In this regard, two main points resulted dramatically significant: a huge managerial expropriation of firm resources and, simultaneously, a great financial damage caused to investors.

Basically that is why, nowadays, in a generally accepted Anglosaxon perspective, corporate governance "deals with the way in which suppliers of finance to corporations assure themselves of getting a return on their investment" (Shleifer, Vishny, 1997: p. 737). In this regard, much of the Anglosaxon research on the topic has been grounded in the agency theory perspective[2]: the agency problem, as known, is referred to the difficulties that shareholders (principals) have in assuring that their funds are not expropriated by managers (agents) or wasted on unattractive projects. Furthermore, in this perspective, the purpose of corporate governance seems convergent with the maximization of shareholders' value, which, as known, has often been argued by Anglosaxon scholars as the main purpose of a firm (Fruhan, 1979; Rappaport, 1986; Stewart III, 1991, 1994; Kaplan, Norton, 1996; Arnold, Davies, 2000).

Outside the Anglosaxon economies, however, the supremacy of shareholders' interests is not automatically accepted by scholars and policy makers. As a result, one of the most significant topics affecting the international corporate governance debate concerns whose interests should be defended by corporate governance systems[3].

Which main features of corporate governance for Italian listed firms could be evidenced? Which monitoring dilemmas could be detected? The essay provides an overview of the Italian corporate governance problem, which takes into account the key features of the ownership structure of firms listed at the Milan Stock Exchange.

[1]Privatisation was not significant in the United States, where state owned firms have always been very few. On the contrary, it was relevant in countries such as Italy, in whose modern capitalism, state has always been one of the most important actors. On the topic see, for example, Cafferata (1995).

[2]On the topic, see the seminal works by Jensen, Meckling (1976) and Fama, Jensen (1983a, 1983b).

[3]On the topic see, for example, the "law and finance" literature (La Porta *et al.*, 1997, 1998, 1999, 2000, 2002) or Gilson (2005).

The essay is divided as follows. First, some evidence concerning the general ownership structure of Italian listed firms in 2004 is provided. Then, some specific terms of the corporate governance problem for Italian listed firms are set.

2. Corporate ownership

Nowadays, equities traded at the Milan Stock Exchange are mainly listed at the *Mercato Telematico Azionario* (hereafter MTA), which is presently managed by Borsa Italiana Ltd. because of the 1997 privatisation of the Milan Stock Exchange[4].

The segmentation of the MTA seems to reflect the main structure of the Italian capitalism, in which, as known, large, small and medium size firms are simultaneously present[5]. Therefore, nowadays the MTA is composed of three sectors: Blue Chips, in which firms with a market capitalization more than 800 million euro are listed; the Ordinary, for firms with a market capitalization lower than 800 million euro; STAR, for firms with a market capitalization lower than 800 million euro which comply with specific disclosure, liquidity and corporate governance standards. Only joint-stock companies (*società per azioni*) and partnerships limited by shares (*società in accomandita per azioni*) are presently allowed to be listed at the MTA.

Following the general macroeconomic trends, the MTA performance was positive in 2004. In this regard, one of the most relevant reasons seemed to be the general increase of listed firms' net income. Furthermore, at the end of the year, the percentage of the stock market capitalization on GDP significantly increased, as shown in figure 1.

[4]More deeply, shares, options, warrants and convertible bonds are allowed to be traded at the MTA, which, in 2004, was the fourth in Europe on the basis of total exchanges value (Borsa Italiana, 2005). Furthermore, the Milan Stock Exchange also includes the "New Market" (for high growth listed firms) and the "Expandi" (for lower dimension listed firms).

[5]Small and medium size firms, more deeply, have always been a relevant feature of the whole Italian industry. On this topic see, for example, Rossi, Toniolo (1996) and Ciocca, Toniolo (2003, 2004). In this regard, a possible supporting statement might be found in the relative underdevelopment which seems to have historically characterized Italian financial markets. On the topic see, for example, Barca (1995) and Rajan, Zingales (2003).

Figure 1: The MTA: some recent indicators (December 31st, 2004)

Year	Stock market capitalization (billion euro) [6]	Stock market capitalization (percentage on GDP)	Amount of share exchanges	Domestic listed firms	Domestic newlisted firms	Domestic delisted firms
2004	569	42.2	641	219	7	7
2003	475	36.6	567	219	9	21
2002	447	35.7	562	231	11	12
2001	575	47.3	637	232	13	18
2000	790	67.8	839	237	16	20
1999	714	64.4	503	241	28	6
1998	484	44.8	423	219	25	15
1997	310	30.2	174	209	14	18
1996	199	20.3	81	213	14	18

Source: Borsa Italiana, 2005

In this section the main features of the ownership structure of Italian domestic firms listed at the MTA will be discussed.

2.1 Ownership and control

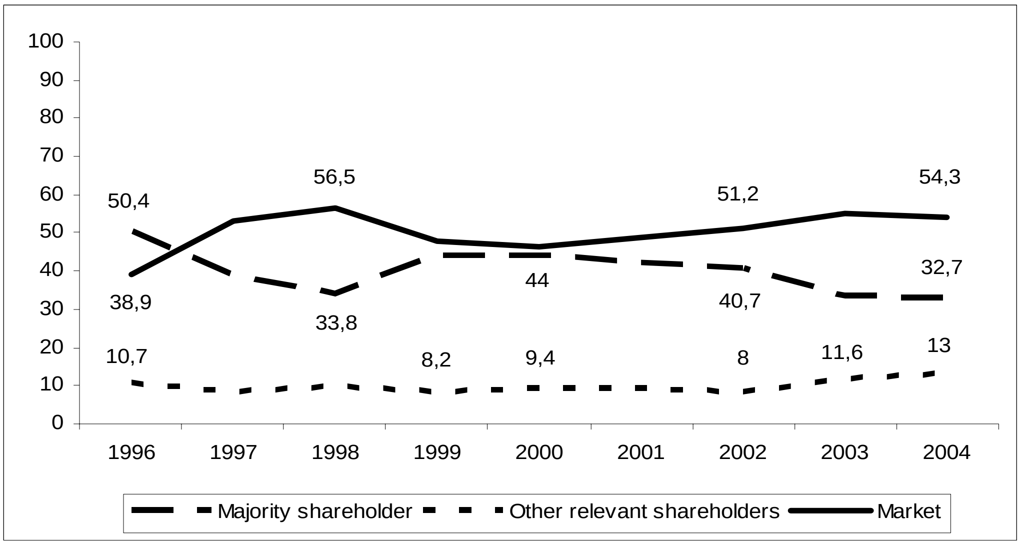
In 2004, the ownership concentration was confirmed as one of the main features characterizing Italian listed firms, although some recent trends continued to be evidenced by data[7]. More deeply, the mean share of the majority shareholder decreased from 50,4% in 1996 to 32,7% in 2004. In the same period, in contrast, the mean market share rose from 38,9% to 54,3%, as shown in figure 2[8].

For what concerns control models, the percentage of *de jure* controlled listed firms decreased from 66,8% in 1996 to 32,7% in 2004[9]. In the same period, on the contrary, the percentage of *de facto* controlled listed firms increased from 12,2% to 27,2%. This evidence, however, does not seem to be confirmed if one

[6]Only domestic listed firms are included in the capitalization data.
[7]For a recent survey on corporate ownership in Italy see, for example, Aganin and Volpin (2003).
[8]This growth was mainly determined by the privatisation of relevant public corporations such as Enel and ENI. On the privatization of ENI see, for example, Cafferata (2002).
[9]It seems clear that, in section 2, the concept of "control" substantially concerns the legal dependence of a firm from another corporation. In section 3, on the contrary, control will basically concern monitoring operations.

considers the data in terms of the number of firms involved, which was substantially stable, as shown in figure 3.

Figure 2: Italian listed firms: ownership concentration[10]



Source: elaboration on Consob, 2005

Figure 3: Italian listed firms: control models[11]

Control model	2004		2003		2002		2001		2000		1999		1998		1997		1996	
	N.	*%*	*N.*	*%*	*N.*	*%*	*N.*	*%*	*N.*	*%*	*N.*	*%*	*N.*	*%*	*N.*	*%*	*N.*	*%*
De jure	134	32.7	130	40.2	142	46.0	135	49.7	141	51.4	148	55.0	128	32.3	122	48.1	130	66.9
De facto	22	27.2	25	25.5	37	28.4	37	22.5	34	18.5	31	16.7	31	21.7	28	12.4	26	12.2
Voting trust[12]	26	15.1	28	15.3	20	10.2	21	11.4	24	9.6	29	10.8	24	7.4	27	6.3	26	4.8
No control	37	25.0	36	19.0	32	15.4	39	16.4	38	20.5	32	17.5	35	38.6	28	38.2	26	16.2
Total	*219*	*100*	*219*	*100*	*231*	*100*	*232*	*100*	*237*	*100*	*240*	*100*	*218*	*100*	*205*	*100*	*208*	*100*

Source: elaboration on Consob, 2005

[10]Data collected on the 31st of December each year. Each mean value in the figure is calculated as the percentage on the total ordinary capitalization of listed firms. Furthermore, according to the L.D. n. 58/1998 (art. 120), "other relevant shareholders" are considered those who own more than 2% of the total voting capital of a firm. All the residual shareholders are included in the "market" share.
[11]Data collected on the 31st of December each year. Each percentage value in the figure is calculated as the ratio between the total ordinary capitalization of firms referring to each specific control model and the total ordinary capitalization of listed firms.
[12]Voting trusts in listed firms are presently disciplined by the L.D.. 98/1998 (art. 122 and 123) in force.

In the figure, data was elaborated according to the legal definition of corporate control set by the Italian Civil Code (art. 2359) and legally in force at the end of 2004. According to the rule, a *de jure* control would occur when a firm owns the absolute majority (51%) of the total voting rights in the ordinary shareholders' meeting of another firm. Differently, a *de facto* control would occur when a firm is able to have a "dominant influence" on another firm. Dominant influence would eventually derive from two situations: first, when a firm owns the relative majority of the total voting rights in the ordinary shareholders' meeting of another firm; second, when a firm has specific contractual relationships with another firm. Finally, a control through a voting trust would occur when the sum of the voting rights included in the agreement substantially results in a *de jure* or *de facto* control[13].

2.2 Governance structures

In the last years, significant rules were established in order to improve the corporate governance system for Italian listed firms[14]. Since 1998, more deeply, the discipline of important topics, such as minority shareholders' protection and take-over rules, was reformed by the above-mentioned L.D. n. 58/1998, also known as "Draghi" Law. In 1999, the first version of the Code of Conduct for Corporate Governance, also known as "Preda Code", was issued by Borsa Italiana. The purpose of the Code, whose compliance is nowadays voluntary, is to improve the accountability of Italian listed firms through the introduction of standard best practices in the definition of governance structures[15].

Finally, in January 2003 the discipline of governance structures for limited liability companies and cooperatives was significantly reformed by the L.D. n. 6/2003, also known as "Vietti" Law. As a consequence, from January 2004 three main different governance models can be adopted by joint-stock companies. The traditional model, formed by the shareholders' meeting, the board of directors and the board of statutory auditors (*collegio sindacale*), is kept as default. The first new governance model mainly reflects the two-tier German one, with a management board (*consiglio di gestione*) and a supervisory board (*consiglio di*

[13]Since January 2005, the European corporate control models have been disciplined by IAS 27 "Consolidated Financial Statements and Accounting for Investment in Subsidiaries". More deeply, IAS 27 sets significant changes for what concerns the concept of corporate control. As a consequence, data in figure 3 would probably result quite different in 2005. Finally, the main features of the top ten Italian *blue chips* in 2004 are shown in the appendix.

[14]For a general survey on the main Italian corporate governance changes in the 20th century see, for example, Ferrarini (2005).

[15]However, companies are required to report on their level of adoption of the Code's provisions, giving reasons for any non-compliance. Furthermore, an update version of the Code was issued in July 2002.

sorveglianza)[16]. Differently, the second new governance model mainly reflects the one-tier Anglosaxon model, with a board of directors, composed of a third at least of independent directors, and a management control committee (*comitato per il controllo sulla gestione*), composed only of independent directors[17]. Indeed, at the end of 2004 the traditional governance model was still largely predominant in Italian listed firms, as it was adopted in about 87% of listed firms (Consob, 2005).

That being stated, in 2004 a particular correlation seemed to be detected between the amount of directors in the boards and the specific control models adopted by listed firms. More deeply, the mean amount of directors was higher in firms that were controlled by a voting trust (12,6%) or that were not controlled at all (12,4%). This might derive from a higher mean amount of executive directors in the above-mentioned control models, as shown in figure 4.

Figure 4: Italian listed firms: mean amount of directors for each control model (December 31st, 2004)

Control model	Executive directors	Non executive directors	Total
De jure	3.0	6.7	9.7
De facto	3.1	7.6	10.7
No control	4.7	7.7	12.4
Voting trust	4.7	7.9	12.6

Source: Consob, 2005

Furthermore, the amount of directors in the boards of listed firms resulted significantly higher for banks and insurance companies. In 2004, 56% of banks and 48% of insurance firms had a board of directors composed of more than 15 members. The same amount, on the contrary, was detected only in 3% of industrial firms and in 4% of services firms, as shown in figure 5.

Figure 5: Italian listed firms: percentage distribution for amount of directors (December 31st, 2004)

Sectors	Amount of directors in the board (in percentage)				
	<6	*6-10*	*11-15*	*>15*	*Total*
Banks	**-**	11.1	33.3	55.6	100.0
Insurance	**-**	19.4	32.3	48.4	100.0
Financial	11.1	52.8	27.8	8.3	100.0
Industrial	15.5	58.8	22.7	3.1	100.0
Services	4.4	55.6	35.6	4.4	100.0

Source: Consob, 2005

[16]On the topic see the Italian Civil Code, arts. 2409-*octies* et seq.
[17]On the topic see the Italian Civil Code, arts. 2409-*sexiesdecies* et seq.

Finally, interlocking directorates continued to represent one of the main features in Italian listed firms. In 2004 this phenomenon was detected in 179 firms, which represented 80% of the total amount of listed firms. In 100 listed firms, more deeply, more than half the directors were simultaneously present in different boards, as shown in figure 6.

Figure 6: Italian listed firms: interlocking directorates (December 31st, 2004)

Amount of directors simultaneously present in more than a board	**Firms**
Less than 25%	66
From 25% to 50%	13
From 51% to 75%	64
More than 75%	36
Total	179
Percentage on the total of listed firms	81,7

Source: Consob, 2005

3. Corporate governance

In 2003, the Italian corporate governance system was dramatically affected by the well-known Cirio and Parmalat financial frauds. Similar features, as will be discussed, were detected in these frauds, with the criminal responsibility of some directors as one of the crucial elements[18].

The Cirio fraud was particularly significant. In the 90s, the firm, which was involved in the agricultural and food industry, significantly grew, with its business structure becoming very complex. The growth was at first financed through consistent bank loans, then through a number of unrated bond emissions[19]. In 2002, Cirio being unable to extinguish a number of expiring bonds, some judiciary investigations were started on the firm's financial reports. As a result, it was found that, for many years, relevant losses and unrecoverable credits had been fraudulently accounted.

Similar features were detected in Parmalat, whose growth in the 90s was implemented through a substantial diversification and internationalization of the

[18]In 2003, the formal state of insolvency was declared by Cirio and Parmalat. As a result, both firms were admitted to the legal procedure of special management (*amministrazione straordinaria*), as ruled by the L.D. n. 270/1999 (updated by the L.D. n. 347/2003 and then by the Law n. 39/2004). Investors damaged by the default of Cirio and Parmalat bonds were respectively about 35,000 (for a total amount of 1.25 billion euro) and 135,000 (for a total amount of 10 billion euro). On the topic see, for example, Pedrizzi, Pontone (2004).

[19]More deeply, at the end of 2002 Cirio Finance Luxemburg in Holland was formally unable to extinguish a 150 million euro bond.

business. The growth was financed by a number of bank loans and bond emissions while simultaneously, financial statements were fraudulently manipulated[20].

That being stated, significant reforms in the Italian corporate governance are, nowadays, substantially claimed. This section will provide an overview of some key questions concerning the external and internal control system for Italian listed firms.

3.1 External control

The recent Italian financial frauds evidenced a consistent loss of reliability in external rating evaluations. In this regard, a first general point would be whether or not the actual present efficiency of external rating can be influenced by the limited number of international players in this business[21]. One would argue that the limited competition is unlikely to strictly influence the effectiveness of external rating. In other words, one would hardly think about limited competition as the most relevant factor affecting the real reliability of the evaluations. On the other hand, however, one would argue that the diffusion of significant information for institutional and private investors could be negatively affected by limited competition. The result could be informative asymmetry and, as a possible consequence, the alteration of specific investment decisions.

At a more focused level, a crucial point concerning external rating is the well-known conflict of interest which could arise from the contractual relationship between the rating agency and the scored firm.

Similar features could be detected in the structure of multipurpose banks. More deeply, some doubts were raised by recent frauds on the effectiveness of “chinese walls” in preventing conflicts of interest. Conflicts, as known, could be the result of the free circulation of information among different sectors of the same bank. Independence, as a consequence, could be significantly influenced while simultaneous operations are worked in progress (e.g. loans, technical analyses, investment and commercial banking services, derivative instrument emissions, etc.).

[20]At the end of 2002, the Parmalat group was formed of 213 firms located in 50 different countries. Only 30 firms of the group were located in Italy. Since 1997, 32 bond emissions were issued by Parmalat, for a total amount of about 7 billion euros. The advisors were mainly a number of important international banks which, simultaneously, financed the firm.

[21]Although its reliability is not subject to any formal legal control, rating is commonly considered as a crucial element to evaluate the wealth of a listed firm. This is the reason for which, in this essay, rating is considered an external control. Furthermore, banks were encouraged by the recent “Basel II” Agreement to set specific internal rating systems. In this perspective banks would be able to internally rate the shares issued by firms they themselves finance. On the topic see, for example, Hertig (2005).

It is common knowledge that independence is crucial for the effectiveness of external control and that is, for sure, one of the key questions concerning the Italian corporate governance system.

That being stated, some evidence from the auditing system for Italian listed joint-stock companies will be discussed. In this regard, the auditor is substantially chosen by the shareholders' meeting[22]. From section I ownership concentration will be remembered as one of the main characteristics of Italian listed firms. This leads to the consideration that the auditor will be substantially chosen by the same subject whose firm shall be audited. As a result, a first significant conflict of interest could arise.

Furthermore, the concept of auditor's independence is still substantially ruled by the P.D. n. 136/1975. Before the Draghi Law, one should remember, a preventive evalutation of the independence was worked externally by Consob[23]. This evaluation, however, was moved to the auditor and the firm itself by the Draghi Law and, as a result, independence is, nowadays, no more subject to the preventive judgement by Consob[24]. More deeply the only preventive evalutation of independence is carried out by the board of statutory auditors of the firm. Since the members of this board, as known, are themselves appointed by the shareholders' meeting, a second conflict of interest could be raised.

That being stated, other conflicts seem possible when auditing and consulting are simultaneously carried out by the same firm or by "network related parties" [25]. In this regard, according to the L.D. n. 88/1992 in force, a firm which wants to act as auditor must be officially admitted into a special register monitored by Consob. The admission is subject to the formal declaration of auditing as the only business purpose of the firm. The law, as known, can be really eluded if the organizational group structure is adopted by the firm. In a group, more deeply, consulting and auditing can be simultaneously carried out through the formation of entities which are often informally related, although legally independent of each other.

Other unsolved questions concern the effectiveness of the rule about the auditor's turnover in assuring that auditing is continuously carried out by substantially independent firms (Onado, 2004)[26]. First, the term for turnover is actually every 9 years and could, at first glance, result too extended in order to achieve the goal. Second, at the end of the term, managers could substantially continue to audit the same corporation simply moving to another auditing firm. Third, the turnover could be substantially ineffective for specific organizational structures. In a group, more deeply, the auditor is legally entitled to pass through

[22]According to the Draghi Law (art. 159) in force, the shareholders' meeting formally appoints, removes and sets the remuneration of the auditing firm.
[23]Consob is the national authority in charge of the control of firms listed at the Milan Stock Exchange.
[24]Both the auditor and the audited firm must only transmit to Consob a legal file in which the formal independence of the auditor is preventively stated.
[25]The concept of «network related parties» was formally set by the European Committee (2002: p. 55).
[26]The turnover is ruled by the Draghi Law (art. 159) in force.

the different firms at the end of the term. In this regard, some evidence from Parmalat could be exhaustive. Due to the turnover rule, Grant Thornton, the auditor of the Parmalat group holding, moved to Bonlat at the end of the 9 years. Bonlat was a firm in the group whose accounting was outside Parmalat consolidated balance sheet and income statement. In Bonlat, as subsequently showed by legal enquiries, most of the group debts were fraudulently accounted.

This leads to final considerations on the role of Consob, from which, as known, auditors are controlled. An effective control by Consob seems negatively affected by its limited economic and legal power[27]. The limitation appears still more significant in the control of auditing for groups, in which two or more firms can act as auditors, the first as "principal", the others as "agents".

3.2 Internal control

In Italy, the importance of the reliability of internal controls is stressed, among other things, by the L.D. n. 231/2001[28].

For what concerns listed joint-stock companies, a first consideration has to be focused on the role of independent directors, whose discipline, as explained, was recently introduced by the Preda Code (art. 3). According to the Code, a director is considered "independent" when he is not involved with the firm in any «relevant» economic relationship which could significantly influence his opinion. Therefore, the "relevance" of the relationship must be related to each director whose independence is checked. In this regard, one could reflect on the real meaning of relevance for an economic relationship between the firm and each of its directors. Should any economic relationship, which allows the director to have his primary needs satisfied, be considered relevant? Should any economic relationship, from which the director is provided with any revenues conceptually comparable to a "first occupation" income, be considered relevant?

This leads to the consideration that some problems could arise while checking the independence of a director. In this regard, one could argue that a possible solution should consist in setting more objective and easily verifiable indicators for the evaluation of independence. As an example, one could consider the income tax return of a director. The incidence of every cash (or cash equivalent) revenue from the board could be calculated on the annual taxable income of the director. In this perspective, if the incidence exceeds a predetermined threshold, above which the economic relationship can be considered such as a "first occupation", the director should be defined "dependent".

[27]On the empowerment of Consob see the recent Law n. 62/2005 on "market abuse", by which this authority is likely to be given more power.

[28]According to the law, more deeply, one would be allowed to charge the firm with the crimes of its managers, if the firm is not able to prove that any appropriate internal control systems had been preventively set.

A number of perplexities would really arise from the stated solution. First, evidence suggests that directors are unlikely to derive their "first occupation" income from the revenues strictly related to their presence in the board. Second, difficulties could be detected in fixing the indicators by which independence is eventually determined. More deeply, the absolute amount of a "first occupation" income seems hardly identifiable. Finally, personal benefits, such as the relational network, coming from the presence in the board, seem hardly accountable. Basically the argued thesis is that, the more a rule is tightening, the more it is effective.

This being stated, another matter of discussion concerns the real effectiveness of stock options in matching the interests of shareholders and managers. One would argue that the strategy of a firm is likely to be negatively affected by the "abuse" of stock options as remuneration instruments. This statement could find an interesting support if one considers the case of managers who are extremely oriented towards the maximization of the shares' value, in order to increase the substantial value of their own stock options. In this case, it is not unlikely that a firm will be directed towards financial goals in the short term, eventually at the expense of competitive long-term strategies.

An overview of the fundamental dilemmas concerning internal controls cannot do without a specific focus on the role of the board of statutory auditors in the traditional governance model for listed joint-stock companies. In this regard, the technical operations of the board will not be discussed by this essay. Instead, specific attention will be given to the method through which statutory auditors are appointed and, subsequently, on its implications on the effectiveness of internal controls[29].

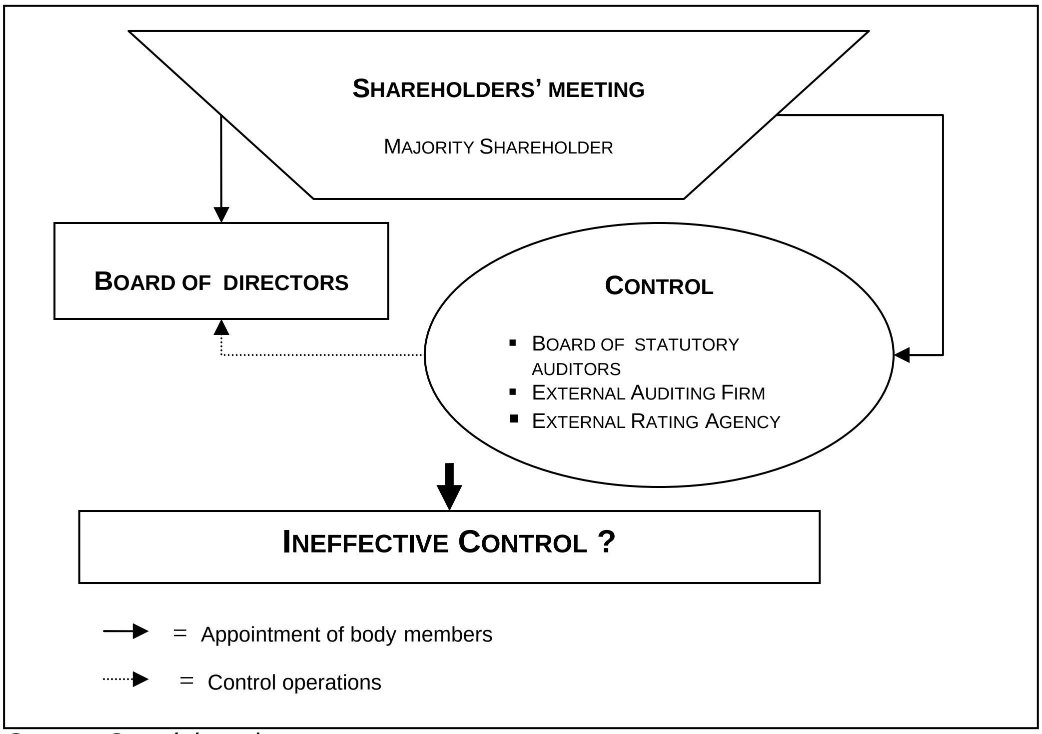
That being stated, in the traditional governance model, the appointment and removal of statutory auditors is decided by the shareholders' meeting. It means that directors, in charge of strategy planning, and statutory auditors, who are legally responsible for the internal control on directors, are simultaneously chosen by the same body. Furthermore, the potentially conflicting scheme, discussed for the appointment of external auditors, is repeated. This leads to the consideration that the effectiveness of controls, at some level, might be negatively influenced by the shareholders' meeting, as shown in figure 7[30]. This statement is perhaps stronger, especially if one remembers that in Italian listed firms, as evidenced, the shareholders' meeting is substantially characterized by the relevant presence of a strong majority shareholder.

Basically, it seems legitimate that directors are appointed in respect of the proportion of the share capital owned by shareholders. The supporting statement is that, the majority shareholder, if any, is theoretically entitled to choose the

[29]The discipline of the board of statutory auditors in listed joint-stock companies is nowadays provided in the Draghi Law in force (art. 148-151).
[30]In the figure, statutory auditors, auditing firms and rating agencies are grouped together into the concept of «control» without any substantial distinction. However, the significant differences concerning their substantial relationship with the shareholders' meeting should be deepened by scholars.

directors who best match his expectations. But for which reason does this proportion have to be repeated in the appointment of statutory auditors? More deeply, as the theoretical function of the board of statutory auditors is quite another matter from planning the strategies of a firm, why does the appointment of its members have to reflect the will of the majority shareholder? Would the effectiveness of internal control increase if the proportion were reversed in the appointment of the members of the board? In this regard, an example could be helpful[31].

Figure 7: Italian listed joint-stock companies: traditional governance structure and control dilemmas



Source: Our elaboration

One could consider a joint-stock company with three shareholders: John, who is the majority shareholder (60% of the total share capital); Desmond (30%) and Michael (10%). According to the rule in force, if one supposes a board of directors with ten members, six directors would be appointed by John, three by Desmond and only one by Michael. This proportion, obviously, would be

[31]Indeed, significant responsibilities are personally taken on by the statutory auditors. As a consequence, one could argue that, although statutory auditors are substantially appointed by the majority shareholder, they do pay relevant attention to supporting his fraudulent wills, when present.

repeated in the appointment of the board of statutory auditors, which is supposed to contain five members. More deeply, about three auditors would be appointed by John, one by Desmond and one by Michael. In this situation, as a result, both the board of directors and the board of statutory auditors are controlled by John.

On the contrast, consider a hypothetic rule by which the proportion is reversed in the appointment of the statutory auditors. In this case, about three auditors would be appointed by Michael, one by John and one by Desmond. As a result, the board of directors would be controlled by John (the majority shareholder), but, what is relevant, the board of statutory auditors would be controlled by Michael (the minority shareholder). Which could be the possible implications of the rule?

Among the positive effects, first the board of statutory auditors might better match the rights of minority shareholders as, in this situation, the board is not strictly dependent to the majority holder[32]. Furthermore, one could argue that the effectiveness of internal controls might be improved[33].

Among the negative effects of this situation, in contrast, one should remember Merton's criticism (1940) towards Weber's bureaucracy. In other words, the goals of the corporate governance system could be negatively diverted by the supposed configuration. The board of statutory auditors, more deeply, could be used by the minority shareholders to stop those directors' operations which might be in contrast with their own expectations. In this regard, however, one should consider that the legal control of directors' operations is substantially the only job for which the board of statutory auditors is formally in charge. As a result, if directors' operations are legally carried out, the board (although controlled by minority shareholders) would have not any specific technical reason to delay or stop the operations. Apart from legal control, however, one could argue that the board could try to delay those directors' operations which do not seem to match the expectations of minority shareholders. In this case, punitive measures should be introduced to discourage the board and the minority shareholders who, eventually, are found responsible for having steered its actions.

Having stated this, a final consideration emerges. One could consider that, theoretically, the primary interest of minority shareholders is the highest remuneration of the money they invested buying the shares of the firm. As a consequence, one could argue that rarely minority shareholders, through the board of statutory auditors, would tend to disturb directors' operations. In this case the performance of the firm would probably result negatively affected and minority shareholders would be one of the first stakeholders to be significantly damaged.

[32]On the topic see, for example, Gatti (2002).

[33]According to La Porta *et alia* (1997, 1998, 1999), the Italian corporate governance system is one of the worst in protecting the minority shareholders.

4. Limitations and implications for future research

In the paper, corporate governance for Italian listed firms has been overviewed. More deeply, specific attention has been put on some control dilemmas raised by the recent Italian financial frauds. In this regard, it is a matter of fact that frauds mostly derive, at first, from a wrong entrepreneurial culture rather than from the ineffectiveness of control systems. At the same time, without any doubt, each of the topics discussed in the essay should be deepened[34].

That being stated, many other issues on the Italian corporate governance should be put in the research agenda. As an example, scholars should deepen the role of cross holdings in the relationship between firms and banks. In this regard, particular attention should be paid to the extent to which conflicts of interest cannot be detected if the bank is simultaneously either a shareholder and a creditor of the same firm, or the advisor of the firm's bonds and shares emissions.

Furthermore, significant attention should concern pyramidal groups, which, as known, are detectable as one of the main features in the ownership structure of Italian listed firms. It is a matter of fact that the main reason for this structure is the possibility to control firms through a limited amount of capital[35]. One of the possible negative implications of this structure, especially among listed firms, might be a substantial lack of balance between the minority and the majority shareholder. As a result, the risk of obtaining private benefits from the control of firm's resources could be higher.

Moreover, relevant questions arise for what concerns the competences and the organizational structure of Borsa Italiana, Consob and the Bank of Italy, who are in charge of the supervision of listed firms, financial markets and banks respectively.

Finally many unsolved dilemmas concern the Italian discipline of related party transactions in corporate groups; the rules on tax and legal havens; the introduction of international accounting standards and the real effectiveness of present sanctions and indemnity systems.

In other countries, in conclusion, significant reforms on corporate governance were quickly issued after the well-known financial frauds. Effective and prompt reforms on corporate governance are also claimed to the Italian research agenda. More deeply, an interesting starting point could be the development of a specific corporate governance evaluation system for Italian listed firms. In this regard, a few key questions on the Italian corporate governance have been simply overviewed in this paper.

[34]In section 3, as an example, statutory auditors, auditing firms and rating agencies were grouped together into the concept of "control" without any substantial distinction. In this regard, an interesting research topic could concern whether their business are indifferently affected by the shareholders' meeting or not.
[35]On the topic see, for example, Bianchi, Bianco, Enriques (2001).

Appendix

The MTA: top ten Italian domestic *blue chips* (December 31st, 2004)

Corp	Market cap. [36]	Sector	Chairman/CEO	Control model
Eni	72,584	Industrial	Poli / Mincato	DE FACTO: Italian Treasury (30.3%) *Other relevant shareholders:* Fidelity Investments (2.01%), Capital Research and Management Company (2.07%)
Tim	46,117	Services	Buora/ De Benedetti	DE JURE: Telecom Italia (56.1%) ([37])
Enel	42,969	Services	Gnudi/ Scaroni	DE FACTO: Italian Treasury (41.8%)
Generali	31,045	Insurance	Bernheim/ Perissinotto - Balbinot	VOTING TRUST: Mediobanca (13.6%), Unicredito (3.65%), Capitalia (3.2%), Premafin (2.4%). *Other relevant shareholders:* Bank of Italy (4.7%)
Telecom Italia	30,936	Services	Tronchetti Provera/ Buora - Ruggiero	DE FACTO: Olimpia (17%) *Other relevant shareholders:* Brandes Invstment Partners (3.6%), Hopa (3.3%), Bank of Italy (2.2%), Generali (2%)

[36] In million euro.
[37] Indeed, the group structure concerning both Tim and Telecom Italia was very articulated at the end of 2004. As a result, the substantial control models were much more complex than those shown in the figure. Furthermore the firms merged in 2005.

Unicredito	26,523	Financial	Salvatori/ Profumo	VOTING TRUST: Fondazione Cassa di Risparmio di Torino (8.7%), Fondazione Cassa di Risparmio Verona, Vicenza, Belluno e Ancona (7.6%), Carimonte Holding (7.1%), Fondazione Cassamarca (3.8%) *Other relevant shareholders:* Allianz Aktiengesellschaft (4.9%), Aviva (2.9%)
Intesa	20,462	Financial	Bazoli/ Passera	VOTING TRUST: Caisse Nazionale de Credit Agricole (15%), Generali (6.3%), Fondazione Cassa di Risparmio di Parma e Monte di Credito su pegno di Busseto (4.9%), Banca Lombarda e Piemontese (2.7%) *Other relevant shareholders:* Commerzbank (4.3%), Brandes Investment Partners (2.7%), Banco Comercial Portugues (2%), Delaware International Advisers (2%)

Sanpaolo-Imi	15,623	Financial	Salza/ Iozzi	VOTING TRUST: Compagnia di San Paolo (14.5%), Fondazione Cassa di Risparmio di Padova e Rovigo (10.8%), Fondazione Cassa di Risparmio di Bologna (7.7%). *Other relevant sherholders:* Banco Santander Central Hispano (7.7%), Giovanni Agnelli & Co. SAPA (3.8%)
Ras	11,244	Insurance	Vita/ Greco	DE JURE: Allianz Aktiengesellschaft (55.5%)
Autostrade	11,025	Services	Gros Pietro/ Gamberale	DE JURE: Schema 28 (52.1%) *Other relevant shareholders:* Banca Popolare di Milano (2%), HSBC Bank (2.6%), Fidelity Investments (2%)

Source: elaboration on Corporate Governance Annual Reports, 2005

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