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Corporate Governance in a Changing Economic and Political Environment

Trajectories of Institutional Change

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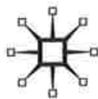

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For Adam Ferran and Dariusz

The sequence of the chapters intentionally avoids any grouping of the countries covered in this book. We start with an analysis of two Western countries, Italy and Spain, presented explicitly as two "outlier" models, to show the specific arrangements of each, as well as the way they have transformed over time. Then Ukraine, Bulgaria, the Czech Republic, Poland, and Hungary are presented. These countries are faced with deep institutional change, with differentiated pace and scope of the transformation process, and various approaches and constellations of actors behind them. In the end, we come back to a Western exemplification of a long-term transformation, that is: France, Switzerland, and Sweden, which were able to recombine national institutional resources when introducing some important new factors. Each chapter presentation builds on its own theoretical framework adjusted to specific national needs. The last chapter reassesses the evolution of corporate governance to explicitly put on the agenda the growing importance of the European Union dimension. This, at present, has a greater impact on candidate countries than member states.

Note

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2

Are Italy and Spain Mediterranean Sisters? A Comparison of Corporate Governance Systems

Ruth V. Aguilera

2.1 Introduction[1]

This chapter argues that corporate governance practices are influenced by institutional features of the economy in which they are embedded, and by the political and economic changes that take place in that economy. The purpose of this chapter is to describe and explain corporate governance models found in two rapidly changing countries, Italy and Spain, and contrast these countries' models with those in other OECD countries. I first describe existing corporate governance models. I then discuss Italy's and Spain's main triggers of change and analyze their respective corporate governance practices by reference to other industrialized countries. Finally, I compare corporate governance practices in these countries and assess where Italy and Spain lie on the spectrum of corporate governance models.

Italy and Spain are two latecomers to industrialization that experienced similar levels of economic development at the beginning of the twentieth century. However, by the late 1970s, there were major differences in these countries' economic organization. Whereas Italy was a developed industrial country and a full-fledged member of the European Community, Spain was a developing country that was beginning an economic and political transition period. Twenty years later, both countries exhibited considerable transformations, with Italy's gross national product ranked fifth among the Western economies in the early 1990s, and Spain's economy demonstrated remarkable development. For example, although Spain's population is about two-thirds of the Italian one and its economy is barely half the size of Italy's economy, in the 1990s the Spanish economy grew by an average of 2.5 percent while Italy reached only 1.6 percent (*The Economist*, July 7, 2001: 6). Furthermore, with the internationalization of these economies, there has been some convergence in their corporate governance models

mostly due to European Union harmonization pressures – namely privatizations. Yet fundamental institutional differences in their economic organization still persist as a result of historical institutional legacies. In this chapter, I examine the differences and similarities among these two countries in the context of other industrialized countries (OECD).

2.2 Corporate governance models

Business corporations comprise different interest groups. These include shareholders, boards of directors, managers, and employees. Corporate governance refers to the relationships between those who own the firm and those who run it, with the key question being who ultimately controls the organization (Berle and Means, 1932; Roe, 1993; Charkham, 1994; Prowse, 1994; Fligstein and Freeland, 1995; Blair, 1995; Fukao, 1995). In trying to answer this quintessential question, the firm has been perceived in two sharply differentiated ways: as an *economic* unit and as a *social* unit.

Organizational economic approaches conceptualize the firm as an economic unit, and study its organization's internal dynamics. Organizational economics includes the following schools: managerial economics (Berle and Means, 1932; Baumol, 1959; Marris, 1964; Williamson 1964), agency theory (Jensen and Meckling, 1976; Fama, 1980; Fama and Jensen, 1983; Jensen, 1993), transaction cost analysis (Williamson, 1985), and property rights (Hart and Moore, 1990; Hart, 1995). They share the assumption that fundamental conflicts of interest exist between shareholders, directors, and managers. A principal drawback of such approaches is that they perceive the firm, in large part, as a black box and not as a nexus in a network or a unit in an organizational environment, and therefore fail to account for external influences on the shape of governance structures.

The social organizational perspective uses a broader lens than the economic account, placing the corporation into external contexts called "survival environments" (resource dependence), "institutional environments" (institutional school) or networks of relationships (Fligstein and Freeland, 1995; Smelser and Swedberg, 1994). In essence, firms are not treated as isolated social units, but instead as embedded in their environments (Granovetter, 1985). They may be constrained by scarcity of resources, by structures of economic and social ties, or by cultural and political structures. Sociological approaches to organizations are sensitive to variations in countries' legal and institutional arrangements. In this chapter, I view the corporation as a social unit influenced by its position in the economic structure and by the historical institutional features of the country within which it is embedded.

Different countries offer corporations varied institutional environments, and such variation is reflected in each country's corporate governance structure. There is an emerging literature discussing how varieties of capitalism are shaped by institutional factors (Hall and Soskice, 2001). These scholars have created a sharp division of national corporate governance models into a dichotomy of ideal-typical cases: the Anglo-Saxon model[2] and the Continental model[3] (Zysman, 1983; Berglöf, 1990; Albert 1993; Roe, 1993; Prowse, 1994; Steinherr and Huveneers, 1994; La Porta et al., 1998). Comparison of these two models of corporate structure suggests that pathways to industrialization, the role of the state in shaping economic policies, and a country's location in the international context will shape differences in corporate governance. These include, in particular, attributes of financial systems, legislation surrounding the structure of corporations, labor and product markets, and regulations affecting foreign capital penetration. These are institutional factors shaping corporate governance models, the influence and operation of which are presented in sections 2.4 and 2.5. Table 2.1 shows a comparison of some of these institutional factors in selected OECD countries.

The Anglo-Saxon model (exemplified by the British and United States country cases) presents an "entrepreneurial" pattern of industrialization. In this model, ownership which tends to be diffused, is held by individual shareholders, and more recently by institutional shareholders (Baums et al., 1994; Useem, 1996). Its market-based financial system exerts a strong influence on corporate structure. Markets play a leading role in managing capital (Steinherr and Huveneers, 1994: 272) through the provision of a wide range of financial instruments and highly developed capital markets (Berglöf, 1990: 244). The model is characterized by diffused ownership, high investor protection, and low employee protection. In addition, the Anglo-Saxon legal tradition draws a sharp line between commercial and investment banks, relies on severe antitrust regulations (for example the 1890 Sherman Act in the United States), and considers interlocking directorates among competing companies to be an illegal practice (the Clayton Act in 1914 in the United States). Further, United States corporate law (the Glass–Steagall Act in 1933) restricts ownership relations between bank and industrial enterprises (Roe, 1993), and thus prevents banks (commercial and investment) from becoming more influential in industry. As a consequence, American banks have been historically small and relatively weak given the size of the US economy.

The Continental model of corporate structure, by contrast, involves bank-controlled and bank-allied companies, and credit-based financial systems favoring low-risk, long-term financing. Banks, particularly the commercial banks, thus exert significant influence over corporate affairs through ownership and governance rights. In Germany, banking influence is accentuated by the organization of most large industrial firms as joint-stock companies (Kocka, 1980: 91). In addition, German banks may exercise direct and continuous power over industrial firms through the supervisory boards (*Aufsichtsrat*) characteristic of the dual board structure of

Table 2.1 Summary of historical institutional factors shaping economic organization in selected OECD countries

	US	*Germany*	*Japan*	*Italy*	*Spain*
1. *Timing of industrialization*					
First railroad track (a)	1825	1835	1872	1840	1850
Year in which agricultural employment fell below 20% (b)	1955	1955	1965	1970	1975
2. *Role of the state*					
Degree of state interventionism	Low	High	Intermediate	High	High
Financial system					
Role of banks	Weak	Strong	Medium	Weak	Strong
Role of stock market	High	Low	Low	Low	Low
3. *International influences*					
Inward direct foreign investment	Medium	Low	Low	Medium	High
Export orientation	Low	High	High	Medium	Medium
Membership in trade blocs	Late (NAFTA) (1989)	Early (1957)	None (1957)	Early (1986)	Late, EC
4. Main domestic entrepreneurs	Individuals and corporations	Banks Families	Sacho-kai State	Families State	Banks Families

Sources: (a) *International Historical Statistics: Europe 1750–1988*, pp. 655–63; (b) *The Fontana Economic History of Europe*, Vol. 5, edited by C. Cipolla (1976).

German corporations (Prowse, 1994). Universal banks are the predominant financial institutions in the Continental model. The coordination of financial activities is often orchestrated by the state, which supports bank lending or actively intervenes through regulation and control of credit allocation (Berglöf, 1990: 245). Direct state intervention in the economy can occur through either the provision of cheap credit to strategic industrial sectors or the establishment of state-owned enterprises. Long-term credit arrangements foster the relationship of banks with industry.

Another main feature of the Continental model is its comparatively underdeveloped capital market and low investor protection, mostly because banks are the chief financing lending institutions. Moreover, contrary to Anglo-Saxon corporate law, Continental model countries exhibit no enforced legal restrictions on the formation of intercompany economic agreements. Thus, in Germany "the 1897 verdict of the German Supreme Court (*Reichsgericht*) [upheld] cartel agreements as legally binding contracts under civil law, even in the cases involving a restraint of trade. And by the interwar period the 'regulated competition' of cartels had become a fully legitimate and accepted form of market organization" (Windölf and Beyer, 1996: 205–6). It was only after World War II that cartels were banned in Germany. Nonetheless, some coalitions of family shareholders (for example Thyssen, Krupp, Flick) and the "Big Three" universal banks were able to rapidly regain their dominant positions in the German economy. Thereafter, cartels came to be regarded favorably as an internal market strategy for international survival. In a nutshell, the main traits of the Continental model are concentrated ownership, low investor protection, a financial model based around banks, and high employment protection.

Finally, it is worth mentioning the Japanese model of corporate structure[4] which has been described as a special case. It is characterized by its main organizational form: the *keiretsu* which emerged as a prolongation of the *zaibatsu*, and as a defensive strategy against the fear of takeovers (Morikawa, 1992). *Keiretsus* are groups of Japanese firms tied together through reciprocal shareholdings, credit relations, trading relations, and interlocking directorships. They became an accepted form of economic organization by the mid-1950s. During the postwar occupation, Americans introduced legal measures modeled on the Glass–Steagall Act that were intended to separate commercial and investment banks. Most large Japanese financial corporations were exempted from these regulations, however, since they were considered strategically crucial for the economic recovery, especially given the underdeveloped stock market in Japan. The Japanese corporate system followed a path distinct from the Anglo-Saxon model, skewing industry financing toward banks and away from the securities market (Roe, 1993: 1955), and promoting a tight external labor market complemented with long-term employment relationships (Gilson and Roe, 1999).

In addition, as Johnson (1982) points out, Japan's "developmental state" became a central actor since the Japanese postwar "economic miracle," primarily through its different state financial institutions (Evans, 1995) and developmental agencies such as Japan's Ministry of International Trade and Industry (MITI). Hence, as in the Continental model, both Japanese banks and the state affected Japanese corporate structure. Contrary to the Continental model, however, the underdeveloped Japanese stock market provided opportunities for groups of investors to get involved as reciprocal shareholders (*Kabushiki mochiai*) (Lincoln et al., 1992). As a result, "[the] board of directors of the Japanese corporation looks remarkably similar to that of Anglo-Saxon corporation in structure" (Prowse, 1994: 42), in that large shareholders are not frequently represented on the board of directors, but rather prefer to influence the firm through informal networks (for example, the *keiretsu* presidents' council: *Shacho-kai*) (Lincoln et al., 1996).

Although there exists a vast research literature on corporate governance in Great Britain, Germany, the United States, and Japan, and a number of studies comparing these countries' models of corporate governance (Franks and Mayer, 1990; Roe, 1993; Charkham, 1994; Prowse, 1994; Bianco and Trento, 1995; Blair, 1995; Fukao, 1995; Shleifer and Vishny, 1997; O'Sullivan, 1996), research on Italian and Spanish corporate governance is scarce. In the following sections, I discuss the Italian and Spanish models of corporate governance, and place these cases within the typology of corporate models just discussed.

2.3 Triggers for change in economic organization

Differences in institutional environments will encourage particular kinds of economic organization over others through structuring the ways that collective actors are constituted, cooperate, and compete for resources and legitimacy (Whitley, 1999: 27). However, it would be naïve to state that the internationalization of markets has not brought industrialized countries together to some degree, if anything else because both communication and transfer of tangible and intangible assets across countries have become a lot easier as a result of globalization. In addition, certain aspects of economic and political institutions put pressures to adapt to the new era. Italy and Spain are at a crosswords in this debate, in the sense that they are shifting their governance models by undertaking major structural changes such as privatizations, deregulations, enacting new legislation, and ultimately furthering the growth of the stock market. Yet, they also need to craft the unique governance mechanisms to enhance their national competitiveness.

One of the possible ways that transformation toward the Anglo-Saxon model recently recoined *shareholder capitalism* may be occurring in Italy and Spain is through contagion. The values and mechanisms underlying shareholder capitalism were generally not created in Italy and Spain but rather were imported from the Anglo-Saxon world with English jargon; for instance *stock options* and *golden shares*. This contagion process began as Italy and Spain were exposed to Anglo-Saxon governance practices first with the entry of Anglo-Saxon multinational firms, and later with institutional investors as well as the perceived idea that companies could enhance their competitiveness by implementing such practices.

In this section, I will examine two economic and institutional factors in Italy and Spain that have exposed and introduced transformations in these countries' economic organization. These are (1) foreign direct investment, and (2) market liberalization resulting in a massive privatization process. A common trend in these macro-level pressures is that they are motivated by the state to strengthen national competitiveness or by suprastate forces such as the need to comply with European harmonization efforts.

2.3.1 Foreign direct investment

Foreign direct investment (FDI) in Italy and Spain was initially dominated by the entry of foreign multinational corporations. In the postwar era, the source of inexpensive labor, particularly suited to high-volume and medium/low-skill operations (such as car assembly) was multinationals' main motivation to settle in Southern Europe, and in the 1970s and 1980s an interest to access the European Union market triggered further foreign investment. The entry of multinational firms was particularly noteworthy in Spain as a consequence of the liberal economic policies implemented during the second period of the Franco regime (1957–77) when economic policy shifted from autarky industrialization to economic liberalization and removal of trade barriers. This trend continued up to the 1990s. Hence, the Spanish government provided significant incentives to attract foreign firms in contrast to Italian protectionism. This is exemplified by the fact that in 1995 the total FDI stock as a percentage of GDP represented 5.7 percent in Italy versus 17.6 percent in Spain (Guillén, 2000: 421).

Although FDI has increased over the years in both countries, the mode of FDI has changed. By the 1990s, foreign investment in Spain shifted from *direct foreign investment*, which does not include direct investment in listed shares but includes portfolio investment in nonlisted shares, to *portfolio foreign investment*, which includes direct investment in listed shares but does not include portfolio investment in nonlisted shares. Hence, while in 1995 direct foreign investment was roughly half of portfolio foreign investment (11,067 million euros), by the end of 2000, direct foreign investment was 39,742 million euros and portfolio foreign investment was 62,212 million euros (OECD, 2001: 24). This is explained by the entry of institutional investors and the internationalization of financial markets. Table 2.2 shows the direct investment inflows in an international comparative perspective for the 1990s. It shows that Spanish direct investment inflows have been above the OECD average and significantly higher than those in

Table 2.2 Direct investment inflows, selected OECD countries, 1990–99 (US$ million)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999p*
Australia[a]	6,513	4,042	5,036	3,007	3,951	13,202	5,171	7,510	6,502	4,441
Austria	647	359	940	982	1,314	636	4,429	2,656	4,902	2,952
Belgium–Luxembourg	7,966	9,292	11,326	10,751	8,313	10,558	14,061	12,093	22,724	15,868
Canada	7,562	2,870	4,717	4,748	8,431	10,780	9,407	11,470	16,499	24,268
Czech Republic	–	–	1,004	654	869	2,562	1,428	1,300	2,540	4,877
France	15,609	15,157	17,855	16,439	15,580	23,681	21,942	23,174	28,955	37,416
Germany	2,492	4,090	2,662	1,915	1,790	13,449	6,577	11,092	21,271	52,403
Hungary	311	1,462	1,479	2,350	1,144	4,453	2,275	2,173	2,036	1,944
Ireland[b]	258	1,168	1,244	850	420	621	1,888	1,676	3,904	5,422
Italy	**6,344**	**2,481**	**3,210**	**3,746**	**2,236**	**4,817**	**3,535**	**3,698**	**2,611**	**5,019**
Netherlands	12,165	6,552	7,824	8,561	7,586	11,611	15,055	14,499	41,977	33,341
Japan	1,806	1,286	2,755	210	888	41	228	3,224	3,193	12,378
Poland	88	359	678	1,715	1,875	3,659	4,498	4,908	6,365	6,471
Spain	**13,839**	**12,445**	**13,352**	**8,073**	**9,425**	**6,217**	**6,820**	**6,387**	**11,797**	**9,357**
Sweden	1,971	6,351	-41	3,843	6,346	14,455	5,076	10,968	19,569	59,102
Switzerland	5,485	2,644	411	-83	3,368	2,224	3,078	6,642	7,499	3,412
United Kingdom	32,889	16,027	16,214	15,468	10,497	22,738	26,084	33,245	64,388	82,176
United States	48,422	22,799	19,222	50,663	45,095	58,772	88,977	109,264	193,375	282,507
Total OECD	177,699	123,396	121,051	150,748	156,408	230,670	248,882	299,004	509,313	683,744

Notes: Data are converted using yearly average exchange rates; *p* = provisional;
[a] Break in series. As from 1995, data are based on the calendar year.
[b] Results shown for Ireland are for net (inward and outward), direct investment capital flows. For 1999 and 1998, balance of payments data.
Data for years 1990–94 are from *Financial Market Trends*, No. 71, November 1998, p. 187 (Table 1). Data for years 1996–99 are from *Financial Market Trends*, No. 76, June 2000, p. 24 (Table 1).
Source: *International Direct Investment Statistics Yearbook* (for years 1990–94), 1998, OECD, OECD/FDI database (for years 1996–99) – based on national sources.

Italy which are consistently lower than in most European countries. A study based mostly on in-depth interviews with key informants in Italy suggests that low Italian foreign investment rates are due to "poor infrastructure, low labor productivity, and fear of organized crime in the South" (Vietor, 2001: 11). Table 2.3 presents the direct investment outflows. Contrary to inflows, outflows have been slightly higher in Italy up to 1996 when Spanish outflows overtook Italian ones mostly due to investments in Latin America. Unlike the case of inflows, the trend in outflows has remained more constant.

FDI continues to grow throughout the OECD countries, reaching $684 billion in inward investment and $768 billion in outward investment in 1999 (OECD, 2000). The primary contributor behind the increase in the 1990s FDI was mergers and acquisitions (M&As). According to the OECD *Financial Market Trends*, in 1999 Western Europe was the world's leading region for cross-border M&As (OECD, 2000: 23), reaching $1 trillion in 1999 and $800 billion in 2000 (*The Economist*, July 7, 2001: 75). Other vehicles behind FDI were deregulation and privatization. Deregulation processes in telecommunications, electricity, public utilities, and financial services industries were either initiated by the harmonization efforts of the European Union or by national governments as a mechanism to enhance competition. The sale of state-owned enterprises to international investors accounted for a large percentage of inward FDI.

2.3.2 Privatization process

Italy and Spain have historically shared strong state intervention through state-owned industrial holdings. The onset of the Italian financial crises in the early 1930s prompted heavy state intervention with the largest relocation of ownership in Italy, with the state at the core of Italian capitalism (Magnani and Trento, 2001). In this process, the Italian government rescued the troubled banks by buying out their industrial holdings and transferring them to a newly created institution, the IRI (Istituto per la Ricostruzione Industriale). IRI was created under the fascist regime in 1933 initially as a transient corporation to rescue troubled banks, although in 1937 it was transformed into a permanent institution. It quickly expanded and became during the postwar years a large industrial conglomerate and key industrializing institution (Castronovo, 1995). The second largest state holding company, ENI (Ente Nazionale Idrocarburi), was founded in 1953 originally to develop Italy's energy's industry. In the 1960s, Italian state-owned firms performed so comparatively well that they became the most dynamic sector of Italian business, and were seen as models to be emulated by other advanced industrial countries.

In Spain, state enterprises were largely developed under the Franco regime as a strategic institution for the import-substitution model of economic growth and also played a key role in the country's industrialization,

Table 2.3 Direct investment outflows, selected OECD countries, 1990–99 (US$ million)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999p*
Australia[a]	265	3,001	951	1,779	5,291	3,728	5,927	6,262	2,466	-3,192
Austria	1,663	1,288	1,871	1,467	1,201	1,043	1,935	1,948	2,948	2,703
Belgium–Luxembourg	6,130	6,493	10,389	4,693	1,205	11,786	8,065	7,273	28,453	24,937
Canada	5,222	5,813	3,586	5,868	9,090	11,165	12,879	22,054	26,575	17,362
Czech Republic	–	–	21	101	120	37	153	25	175	197
France	36,220	25,115	30,416	19,732	24,381	15,760	30,395	35,586	41,913	88,324
Germany	23,964	23,623	19,526	15,320	17,179	38,791	50,841	40,716	91,183	98,853
Hungary	–	–	–	11	49	43	-3	431	481	249
Ireland[b]		–		–		–		–	8,569	18,326
Italy	**7,612**	**7,326**	**5,948**	**7,221**	**5,109**	**5,732**	**6,465**	**10,619**	**12,078**	**3,038**
Japan	50,744	31,688	17,301	13,916	18,117	22,629	23,424	25,991	24,159	20,730
Netherlands	15,288	13,577	14,366	12,343	17,405	19,629	31,230	29,247	51,365	45,540
Poland	–	–	13	18	29	42	53	45	316	123
Spain	**3,442**	**4,424**	**2,171**	**2,648**	**3,900**	**3,608**	**5,590**	**12,547**	**18,935**	**35,421**
Sweden	14,743	7,053	409	1,357	6,698	11,221	4,664	12,648	24,376	18,951
Switzerland	6,709	6,212	6,050	8,765	10,798	12,214	16,150	17,747	16,631	17,910
United Kingdom	18,636	15,972	19,156	25,573	28,251	44,329	34,125	61,620	119,463	199,275
United States	30,982	32,696	42,647	78,164	73,252	92,074	92,694	109,955	132,829	152,152
Total OECD	231,018	191,430	178,589	202,230	237,418	307,366	340,977	414,079	636,480	767,814

Notes: Data are converted using yearly average exchange rates; *p* = provisional;
[a] Break in series. As from 1995, data are based on the calendar year.
[b] Results shown for Ireland are for net (inward and outward), direct investment capital flows. For 1999 and 1998, balance of payments data.
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Source: International Direct Investment Statistics Yearbook (for years 1990–94), 1998, OECD, OECD/FDI database (for years 1996–99) – based on national sources.

mostly in the heavy industry sector and the military. State-owned firms were notably concentrated within the state industrial holding company INI (Instituto Nacional de Industria) created in 1941 following the Italian model (Martín Aceña and Comín, 1991). The state-owned systems of Italy and Spain are similar in that they did not emerge as a deliberate policy of nationalization but were the by-product of corporate salvage operations and import substitution models of economic development.

However, by the 1970s, state-owned firms began to experience operating losses, and developed a strong dependence on government funding. As Magnani and Trento point out, for the Italian state, but also applicable to the Spanish one, "as well as acting as an owner, the [Italian and Spanish] states have constantly made up for failures in the governance environment of private companies by providing them with a steady flow of resources and supplying subsidies to realize delayed restructuring" (2001: 17). In both countries, the state holdings bought out mismanaged companies, and particularly in the Italian case, because most banks were under the auspices of IRI, they transferred funds to entrepreneurs to overcome situations of financial distress, and guaranteed subsidized credit. In the 1980s, state-owned firms were riddled with managerial inefficiency and political corruption, and there were several attempts to restructure and privatize state holdings. As a consequence, state-owned firms have been subject to rationalization and restructuring with successive waves of privatization since the 1980s. IRI was liquidated following the European Commission mandate in mid-2000. In 1995, INI was dismantled into two strategic institutions whose economic goals were industrial restructuring, and in 1997 with the new Spanish conservative government, all industrial state-owned assets were transferred again under a single institutional umbrella, SEPI (Sociedad Estatal de Participaciones Industriales) for reorganization and further privatization (Gámir, 1999). Despite the common strong state intervention in both countries there are some differences in degree. Thus, in 1990, Italian state-owned firms still accounted for the highest percentage of public ownership as a percentage of the overall economy (20 percent) among the European countries closely followed by France (18 percent) (Macchiati, 1996: 27).

The major shift in state interventionism was the privatization process. Italy, France, and Spain experienced an extensive privatization process starting in 1992, as is shown in Tables 2.4 and 2.5. This privatization process became a central part of their national economic policies and was exceptionally accelerated in the years prior to the launching of the euro due to the governments' need to meet the fiscal objectives of the new monetary union (particularly decrease public debt), coupled with the European Union directives requiring liberalization of markets.

Privatization has been an important mechanism to bring small investors into the financial market, to expand the number of traded firms and to boost the overall capitalization of the domestic stock exchange. Individuals and

Table 2.4 Country breakdown of global amount raised from privatization (US$ million)

	1990	*1992*	*1994*	*1996*	*1997*	*1998*	*1999p*
Italy			**6,493**	**6,265**	**27,719**	**13,619**	**25,611**
France			5,479	5,099	8,189	12,951	9,509
Spain	**172**	**820**	**1,458**	**2,679**	**12,522**	**11,618**	**964**
Japan			13,773	6,379	4,009	6,641	14,856
Portugal	1,192	2,326	1,132	3,011	4,968	4,260	1,624
Greece			73	558	1,395	3,892	4,880
Austria	32	49	700	1,251	2,020	2,426	138
Poland	23	238	385	749	2,179	2,079	3,422
Finland			1,166	911	835	2,068	3,645
Belgium			549	1,222	1,562	2,277	–
Mexico	3,122	6,859	766	73	2,690	987	291
Czech Republic			1,077	994	442	469	781
Germany			240	13,228	1,125	364	6,734
Hungary	38	720	1,017	1,157	10966	353	88
Netherlands	716		3,766	1,239	831	335	1,481
Sweden		378	2,313	785	1,055	172	2,071
UK	12,906	604	1,341	7,610	4,544	–	–
Total OECD	24,822	16,617	47,284	69,347	95,955	85,886	100,765
of which EU 15	15,662	4,247	24,940	44,518	66,812	58,484	61,522
Other countries	5,078	19,845	18,111	27,911	57,827	45,153	44,000
Global total	29,900	36,462	65,395	97,258	153,782	131,039	144,765

Source: OECD (2000: 46).

Table 2.5 Receipts from privatization (as % of GDP)

	1993–95	*1996–98*
Portugal	1.4	3.9
Hungary	5.2	2.5
Spain	**0.5**	**1.6**
Greece	0.0	1.6
Italy	**0.5**	**1.4**
Poland	0.4	1.2
Czech Republic	1.7	1.2
Finland	0.6	1.0
Austria	0.3	1.0
France	0.6	0.6
Belgium	0.6	0.6
Mexico	0.3	0.3
Netherlands	0.8	0.2
Japan	0.2	0.1

Source: OECD (2000).

institutional investors become shareholders and the state slowly fades away. Moreover, privatizations tend to offer special issues for employees, who then also become minority owners. However, the hand of the state is not so invisible, since most of these privatizations are accompanied by *golden shares* where even in the case in which the state has a minority stake it might have a veto power over strategic decisions such as mergers or takeovers.

The first privatizations pre-1990s were undertaken with the method of sale to strategic buyers; in the 1990s public offerings became the main method of sale. Public offerings require sophisticated financial markets and a well-developed legal infrastructure for companies that are not already listed, and tend to be placed in the hands of institutional investors, some of them foreign. More recently, the initial public offering also includes incentives for minority shareholders to become involved. Consequently, for instance in Spain, the subscription of minority shareholders has almost doubled since the implementation of the "Spanish Privatization Plan" in 1996. The scenario is similar in Italy. In 1999, Enel (Italy's largest electricity company) undertook the world's largest IPO being oversubscribed five times by both retail and institutional investors (OECD, 2000). Enel's sale of the second tranche will take the government stake below 50 percent. In 1999, the breakdown of privatization offerings was 56 percent to the public in Italy, 5 percent to employees, and 39 percent to institutional investors and individuals abroad, which represents according to Consob (2000: 10) an increase in the proportion placed with institutional investors and a decrease in the proportion absorbed by the Italian public compared to offerings in the two previous years.

In Spain, the state coffers received 30 billion euros as a result of selling 40 state-owned enterprises: Endesa (electricity), Aceralia (steel), Iberia (flagship airline), and Telefonica (telecommunications) among others in the last four and a half years (between June 1996 and April 2001) (CCP, 2001). The Italian privatization is the largest ever realized in a European country. It generated a total gross proceeds of more than 85,000 million euros (Magnani and Trento, 2001: 24). Of the privatized companies since the start of the Italian privatization program in 1992, 13 have been included in the Mib30 index, accounting for 60 percent of the Mib30 (Italian blue chip index) and 48 percent of the total capitalization of the stock exchange (OECD, 2000: 47). The privatization process also resulted in the hostile takeover, a common economic action in shareholder capitalism, of a recently privatized Telecom Italia by Olivetti in February 1999. Tables 2.6 and 2.7 list the main privatizations in Italy and Spain respectively.

2.4 Corporate governance in Italy

Italian capitalism has been termed "political capitalism" (Amatori, 1997), "entrepreneurial capitalism," and "flexible capitalism" (Porter, 1990; Piore

Table 2.6 Main privatizations in Italy, 1993–2001

Year	*Corporation (group)*	*Method of sale*	*Percentage sold*
1993	Italgel (IRI)	Private agreement	62.12
	Cirio–Bertolli–DeRica (IRI)	Private agreement	62.12
	Credito Italiano (IRI)	Public offering	58.09
	SIV (RFIM)	Auction	100.00
1994	IMI – 1st tranche	Public offering	32.89
	COMIT (IRI)	Public offering	54.35
	Nuovo Pignone (ENI)	Auction	69.33
	INA – 1st tranche	Public offering	47.25
	Acciai Speciali Terni	Private agreement	100.00
	SME – 1st tranche	Private agreement	32.00
1995	Italtel (IRI)	Auction	40.00
	Ilva Laminati Piani (IRI)	Private agreement	100.00
	Enichem Augusta (ENI)	Auction	70.00
	IMI – 2nd tranche	Private agreement	19.03
	SME – 2nd tranche (IRI)	Accept takeover bid	14.91
	INA – 2nd tranche	Private agreement	18.37
	ENI – 2nd tranche	Public offering	15.00
	ISE (IRI)	Auction	73.96
1996	Dalmine (IRI)	Auction	84.08
	Italimpiati (IRI)	Auction	100.00
	Nuova Tirrena	Auction	91.14
	SME – 3rd tranche (IRI)	Accept takeover bid	15.21
	INA – 3rd tranche	Convertible bond issue	31.08
	MAC (IRI)	Auction	50.00
	IMI – 3rd tranche	Public offering	6.94
	Montefibre (ENI)	Public offering	65.00
	ENI – 2nd tranche	Public offering	15.82
1997	ENI – 3rd tranche	Public offering	17.60
	Aeroporti di Roma (IRI)	Public offering	45.00
	Telecom Italia	Core investors + public	39.54
	SEAT editoria	Core investors + public	61.27
	Banca di Roma (IRI)	Public offering + bond	36.50
1998	SAIPEM (ENI)	Public offering	18.75
	ENI – 4th tranche	Public offering	14.83
	BNL	Public offering	67.85
1999	ENEL	Public offering	35.00
	Autostrada (IRI)	Auction + public offering	57.00
2000	Autostrada (IRI)	Private agreement	30.00
	Finmeccanica (IRI)	Public offering	43.70
	Aeroporti di Roma (IRI)	Private agreement	51.20
	Banci di Napoli	Public offering	16.16
2001	ENI – 5th tranche	Accelerate book building	5.00

Sources: Magnani and Trento (2001: 30–1, Table 11); company accounts (various years); Ministry of Treasury, *Relazione sulle privatizzazion* (various years); financial press.

Table 2.7 Spanish privatizations, 1985–99

Year	*Firm*	*Owner*	*Percentage sold*	*Buyer*
1985	Textil Tarazona	INI	69.6	Cima Enursa
	Igenasa	INI (Enisa)	67.7[a]	ERT
	Igfisa	INI (Endiasa)	100.0	Pleamar
	Cesquisa	INI (Enisa)	45.4	Cepsa
	Secoinsa	INI	69.1	Fujitsu España/Telefónica
	SKF Española	INI	98.8	Aktiebogalet SKF
	Marsans	INI	100.0	Trapsatur
	Gossypium	DGPE/Itelhorce	100.0	Textil Guadiana
1986	Entursa	INI	100.0	CIGA
	Frigsa	INI (Endiasa)	100.0	Saprogal/ H. de Lujo Esp.
	Gypisa	INI (Endiasa)	100.0	Frig. Santana/Los Norteños
	La Luz	INI (Carcesa)	100.0	Prevert
	Insisa	INI (BWE)	60.0	Acctas. Privadas de Insisa
	Remetal	INI (Inespal)	66.6[b]	Remetal
	Issa	INI (Inespal)	100.0	Aluperfil
	Aluflet	INI (Aluminia)	40.0	Actas. Privadas de Aluflet
	Motores MBD	INI (Motores Barrera/ Sodiga)	60.0[c]	Klockner Humboldt Deutz AG
	Pamesa	INI (Ence)	100.0	Torras Hostench
	Fovisa	INI (Made)	100.0	Gekanor (GKN/Acenor)
	Indugasa	INI (Seat)	50.0	GKN
	Seat	INI	100.0[d]	Volkswagen
	Telesincro	INI (Inisel)	100.0[e]	Bull
	Gesa	–	30.0	IPO (Institutional)
1987	Dessa	INI (Bazán/Ast)	80.0	Forestal del Atlántico
	Evatsa	INI (Inespal/So)	100.0	Cebal
	Lifotan	INI (Inespal)	100.0	Baumgartner Ibérica
	Alumalsa	INI (Inespal)	44.0	Montuper
	Purlator	INI (CASA)	97.4	Knecht Filterwerk

Table 2.7 Spanish privatizations, 1985–99 *Continued*

Year	Firm	Owner	Percentage sold	Buyer
	Vict. Luzuriaga	INI	33.3	Eisenwerk Bruhl
	Diasa	INI (Endiasa)	50.0	Saudisa (Promodes)/BBV
	Miel Española	INI (Endiasa)	51.0	Sugemesa (Agrolimen)
	Miraflores	INI (Lac. Cast.)	–	Queserías Miraflores
	Acesa	INI (Bazán/Ast)	29.0	IPO (Institutional/Minority)
	Telfónica-87	INI (Inespal/So)	6.0	IPO (Institutional)
	Ence-87	INI (Inespal)	40.0[f]	IPO (Institutional)
1988	Endesa		20.4[g]	IPO (Institutional/Minority)
1989	Astican	INI	90.72	Italmar
	MTM	INI	100.0[h]	GEC Alsthom
	Ateinsa	INI	100.0[i]	GEC Alsthom
	Enfersa	INI	100.0[j]	Ercros
	Oesa	INI (Endiasa)	100.0	Ferruzzi
	Pesa	INI (Inisel)	97.4	Amper
	Ancoal	INI (Enisa)	75.2	Omnium Industrie
	Repsol	INH	26.0[k]	IPO (Institutional/Minority)
1990	Adaro Indonesia	INI (Enadimsa)	80.0	Indonesia Coal/Asmico, etc.
	Hytasa	DGPE	100.0	Textil Guadiana
	Imepiel	DGPE	100.0	DFG Grupo Cusi
	Dirsa	DGPE (Tabac.)	75.06	Diasa (Promodes/BBV)
	Seb. de la Fuente	DGPE	100.0	Cofidisa
	Salinas de Torrevieja	DGPE	38.5	U. Salinera de Esp. (Solvay)
	Coifer	DGPE (Tabac.)	50.0	Alimentos Naturales (BBV)
1991	Enasa	INI	100.0	Iveco
	G. Emp. Alvarez	INI	100.0[l]	Iveco
	TSD	INI (Enosa)	100.0	Telepublicaciones
	Fridarago	DGPE (Tab.)	100.0	Rústicas
	Coisa	DGPE (Tab.)	100.0	Rústicas

Table 2.7 Spanish privatizations, 1985–99 *Continued*

Year	Firm	Owner	Percentage sold	Buyer
	Jobac	Mercasa	100.0[m]	Eosmer Consm (Eroski)
1992	Icuatro	INI (Iniexport)	90.0	Grupo Alegre
1993	Automoción 2000	INI (Teneo)	100.0	Inversores Reo
	Fábrica S. Carlos	INI (Teneo)	100.0	G. Navacel/Total Chemical Trade
	Palco	INI (Inespal)	100.0 [n]	Alcan Deutschland
	Royal Brands SA	DGPE (Tabac.)	100.0	RJR Alimentación (50% Tabac.)
	Ineco	Renfe	66.0[o]	–
	Argentaria	INI (Teneo)	25.0[p]	IPO (Institutional/Minority)
1994	C. Trasatlántica	INI (Teneo)	100.0	Naviera de Odiel/Mar. Valenciana
	Arteespaña	INI (Teneo)	100.0	Medino, S.L.
	ASDL	INI (Ceselsa)	87.7	Quadrant Group
	Sodiga	INI	51.2	Xunta de Galicia
	Enagas	INH	91.0[q]	Gas Natural
	Caivsa	INH	100.0	Gas Natural
	RJR Alimentacio	DGPE (Tabac.)	10.7	RJR Nabisco
1995	Refinalsa	INI (Inespal)	50.0	Remetal
	Sidenor	AIE	50.0	Digeco-Roda
	Lesa	DGPE (Tabac.)	100.0	Leyma/Iparlat
	Telefónica		10.7[r]	IPO (Institutional/Minority)
1996	Almagrera	SEPI	99.98	Navan Resources
	Gas Natural	SEPI	3.81	IPO (Institutional)
	Sefanitro		52.65	
	Sodican		51.0	
1997	Aldeasa	SEPPa	80.0	IPO (Institutional/Minority)
	Aceralia	SEPI	52.8	IPO (Institutional/Minority)
	Iongraf	SEPI	100.0	MBO
	Sodical	SEPI	51.0	Shareholders + Caja R. del Duero
	Surgiclinic Plus	AIE	50.0	Hambros

Table 2.7 Spanish privatizations, 1985–99 *Continued*

Year	Firm	Owner	Percentage sold	Buyer
	Auxini	SEPI	60.0	OCP
	Retevisión	Mins. De Fomento	60.0	STET and Endesa
	CSI-Aceralia	AIE-SEPI	47.2	ARBED & Corp. J. M. Aristrain
	Elcano	SEPI	100.0	Grupo MarítimoIbérico
	Tisa	SEPPa	23.78	Telefónica
	Ferroperfil	SEPI	100.0	MBO
	Inespal	SEPI	99.6	Alcoa
	Infoleasing	SEPI	100.0	Liscat (Caixa de Catalunya)
	Hijos de J. Barreras	SEPI	99.99	Grupo Barreras
	Sodicamán	`	51.0	
1998	Tabacalera	SEPPa	52.0	IPO (Institutional/Minority)
	Productos Tubulares	SEPI	100.0	Tubos Reunidos
	Inima	SEPI	100.0	Lain
	Comesa	SEPI	100.0	Several buyers
	Serausa	SEPPa	100.0	Areas, S.A.
	Grupo Potasas	SEPI	100.0	Dead Sea Works (DSW)
1999	Indra	SEPI	66.1	IPO (Institutional/Minority)
	Red Eléctrica de Esp	SEPI	31.5	IPO (Institutional/Minority)
	Icsa-Aya	SEPI	100.0	Mecanizaciones Aeronáuticas
	Enatcar	SEPI	100.0	Alianza Bus

Table 2.7 Spanish privatizations, 1985–99 *Continued*

Year	Firm	Owner	Percentage sold	Buyer
	Astander	SEPI	100.0	Italmar
	LM Compos Toledo	SEPI	50.0	LM Composites
	Iberia	SEPI	54.0	BA, AA, institutional domestic investors
	Initec	SEPI	100.0	Técnicas Reunidas & Westinghouse
	Casa (closed 2000)			

Notes: Companies are classified by date of first privatization.
[a] 51% in 1985; 14.2 in 1986; and 2.4 in 1989.
[b] 66.1 in 1986; 0.5 in 1990.
[c] 38.4 in 1986; 21.6 in 1989.
[d] 75 in 1986; 25 in 1990.
[e] 40 in 1986; 33.9 in 1988; 26.1 in 1994.
[f] 40 in 1987/8(?); 15 in 1995; 45 in 1996 and 1997.
[g] 20.4 in 1988; 8.6 in 1994; 25 in 1997; 46 in 1998.
[h] 85 in 1989; 15 in 1992.
[i] 85 in 1989; 15 in 1992.
[j] 80 in 1989; 20 in 1991.
[k] 26.4 in 1989; 4.2 in 1989; 2.9 in 1990; 2.1 and 9.8 in 1992; 14.1 in 1993; 19.5 in 1995; 11 in 1996; and 10 in 1997.
[l] 60 in 1991; 40 in 1993.
[m] 70 in 1991; 30 in 1995.
[n] 50 in 1993; 50 in 1994.
[o] 55 in 1993; 11 in 1994.
[p] 25 in April 93; 25 in November 1993; 25 in 1996; and 25 in 1998.
[q] 91 in 1994; 9 in 1997.
[r] 10.7 in 1995; 21 in 1996.
Sources: Gamir (1999: 100–3, 105, 118–21, 136–42); Fernández Ordóñez (2000: 160–1); Anuario El PAIS (2001: 428).

and Sabel, 1984). This is because the Italian economy includes a small number of large corporations that were already part of Italy's industrial capitalism at the outbreak of World War II,[5] together with a vast network of small- and medium-sized firms,[6] a highly interventionist state, and a fairly protectionist economy.

This section describes corporate governance patterns for Italian corporations, mostly large firms. I begin by describing the Italian corporate law and types of corporations, and the structure of corporate ownership and control. I then discuss the system of corporate finance, particularly the role of banks, the stock market, and institutional investors.

2.4.1 Corporate law and types of corporations[7]

The Italian Civil Code of 1942 is, with few exceptions, the principal source of Italian corporate law (Colombo and Portale, 1991; Galgano, 1997). Until very recently, the government had not created a suitable corporate legal framework within which modern business could develop and flourish in Italy, with little financial transparency and protection for minority shareholders. However, since the early 1990s, the harmonization of European corporate law, the internationalization of the economy, and the necessity to have a competitive business and financial system have led to reforms in the Italian corporate governance environment.[8]

Italian company law provides for three main forms of corporations: the Società per Azioni, SpA (stock company), the Società in Accomandita per Azioni, Sapa (stock company with personally liable directors), and the Società a Responsabilità Limitata, SrL (limited liability company) (Zattoni, 1994). The legislative company model is based on the SpA. Medium and large firms, as well as most publicly traded firms, are legally structured as SpA. The Sapa was intended as a device to facilitate the raising of capital by a personally liable entrepreneur, usually well-known to and trusted by the public. This is the characteristic corporate form for top holding companies of large business groups.[9] The limited liability corporate form (SrL) is adopted by small and medium-sized firms and is the predominant corporate form in the Italian economy. It becomes less common as a firm's size increases. According to Stranghellini (1995: 101), when companies grow, they adopt the form of SpA for corporate image reasons. SpA are considered more stable and "serious." The distribution of power in an SpA is legally allocated among three corporate bodies: shareholders, a board of directors, and a board of auditors.

As of 1993, of the 1000 largest Italian industrial companies, classified by annual turnover, 810 were SpA, and 116 SrL. The rest were cooperatives and consortia, foreign companies, or public entities. Of the top 100 companies, most are SpA; there are six SrL, and seven cooperatives. Most banks and insurance companies are required to adopt the legal form of SpA or *società cooperativa* (cooperative societies). Thus, in 1992, out of the

50 largest banks, classified by total assets, 39 were SpA, 10 were cooperatives and one was a state-owned entity with a special regime (Monti dei Paschi di Siena). Finally, all of the 100 largest insurance companies (with the exception of a few mutual insurance companies), ranked by total premiums collected, were SpA (*Il Mondo Economico*, December 25, 1993).

2.4.2 Type of corporate ownership

Shareholders, mostly in the form of block holders, play an active role in Italian corporate governance, and have the final say in fundamental company matters such as capital structure, dividend policy, and firm strategy such as mergers. Shareholders govern a corporation via majority rule. Ownership entities involve the following: individuals, domestic enterprises (nonfinancial enterprises), financial holding companies, with no manufacturing activity, foreign companies, and the state.

There is a distinction in ownership patterns between those companies that are listed in the stock market and those which are not. The latter, small to medium-sized companies, are usually controlled by a single individual (the founder) or by very homogeneous shareholders (a close group of shareholders, often members of the same family). They generally do not have state or foreign capital, nor do they receive institutional investments, because the family intends to retain control of the firm. Barca et al. (1994: 45–60) demonstrate that there is a strong negative relationship between number of employees and percentage of individual ownership for small and medium firms. From their survey of 286 Italian firms of 20–500 employees in 1993, they show that in those firms with less than 50 employees, 80 percent of the ownership belongs to individuals (1994: 51).

As for companies listed on the Italian stock market, aggregate statistics on direct ownership demonstrate the coexistence of different types of shareholders. Table 2.8 shows ownership percentages of listed companies in comparative perspective. It is to be noted that Italian financial corporations (including banks and domestic institutional investors) play a relatively small role compared to other selected OECD countries. Italian financial entities hold 14 percent of the shares in listed firms versus 21.2 percent in Spain, and 47 percent in the US and 68 percent in the UK. Even though 10.9 percent of bank ownership might seem high, it is important to note that these banks are mainly state-owned, as will be discussed in section 2.4.4. Foreign ownership is also rather low in Italy in comparative perspective, partly as a consequence of protectionist policies and the predominance of small and medium-size firms. By contrast, the domestic nonfinancial sector owns 82 percent of the capital of listed firms in Italy. The latter accounts for the large state-owned enterprise sector and family-run enterprises compared to other countries. According to Table 2.8, Italy has the highest percentage of state ownership of listed firms, at 28 percent, of the seven OECD countries selected.

Table 2.8 Ownership of listed companies in selected countries in 1996 (%)

	Italy	*Spain*	*Germany*	*France*	*Japan*	*US*	*UK*
Domestic institutional investors	3.0	7.2	20	20	27	40	58
Banks	10.9	14	10	10	15	7	10
Foreign institutional investors	4.3	27.6	9	25	11	5	9
State	28	11	4	3	1	0	1
Individuals (families)	32.2	23.6	23	15	20	49	21
Nonfinancial firms	21.6	6.9	42	19	26	–	1
Other[a]	–	9.7	–	–	–	–	–
Total	100	100	100	100	100	100	100

[a] Foreign noninstitutional.
Source: Eguidazu (1999: 250–1).

As a result of Italy's effort to create a more transparent stock market, some ownership data have recently been made public by the Regulatory Stock Commission, Consob. Table 2.9 shows a consistent yet updated pattern from Table 2.8. Two main trends are worth highlighting. First, there is a slight increase in the number of foreign investors and institutional investors, which is explained by the liberalization of financial markets and privatization public offerings. Second, there is a decreasing trend in the percentage of state ownership. The Consob Annual Report (2000) states that there has been a reduction in the share of market capitalization of companies controlled by the state from 28 percent in 1995 to 25.6 percent in 1998. State ownership of publicly traded firms is closely linked to the privatization efforts. While privatization efforts in Italy started in the early 1990s, the peak of this process was not until 1996, and it slowed considerably in the following years. Still the low visible turnover of ownership types can be explained by the financial obstacles to new entrants, stickiness of the model of family control, and collusion between top management teams of state-owned firms and politicians, which according to Magnani and Trento (2001: 20) cause adverse effects on long-term growth and on equity.

2.4.3 Corporate control

Until very recently it was difficult to know the ownership concentration of Italian and Spanish firms because of the lack of disclosure requirements. The European Commission's 1988 transparency directive required all member states to disclose large ownership stakes and voting rights (Becht and Röell, 1999). This directive in itself shakes the governance culture in both Italy and Spain.

Ownership concentration is assessed by examining the percentage of corporate control held by the largest owners. Table 2.10 demonstrates that

Table 2.9 Significant shareholdings in Italian listed companies[a]

	1997		*1998*		*1999*		*2000*	
	No.	*%[b]*	*No.*	*%[b]*	*No.*	*%[b]*	*No.*	*%[b]*
Foreign investors	166	5.0	176	5.9	193	6.2	233	6.5
Insurance	22	2.2	32	2.5	36	1.5	27	3.2
Banks	79	5.1	65	4.8	83	5.3	66	5.9
Foundations	42	3.1	31	5.1	43	4.5	49	5.0
Institutional investors	50	0.1	69	0.1	74	0.2	82	0.3
Companies	150	14.4	155	12.6	162	19.4	151	17.2
State	44	12.1	32	8.8	35	10.6	37	10.2
Individuals	266	4.8	233	3.8	253	4.5	254	4.9
Total	819	46.8	793	43.6	879	52.2	899	53.1

[a] Shareholding exceeding 2% of the voting capital.
[b] Percentage of the value of the shareholdings to market capitalization.
Source: Consob (1998, 1999, 2000).

Table 2.10 Ownership concentration in individual firms in OECD countries (% of largest owner's share of capital)

Largest owner's share	*Italy* (1994)[a]*	*Spain (1990)[b]*	*France (1982)[c]*	*US (1986)[d]*	*Japan (1983)[e]*	*UK (1976)[f]*	*Germany (1985)[g]*
> 50	60	49	55	9	5	2	66
30–50							23
25–30				29		9	
20–25					70		
15–20	40	49	42			5	12
10–15				10			
5–10				29	25	32	
< 5		2	2	23		52	

Sources:
[a] OECD (1994–95) Italy.
[b] Galve Gorriz and Salas Fumás (1993=213).
[c–g] Berglof (1990: 248).

corporate ownership is more concentrated in Italy than in any other major OECD country. For example, in 1994, 60 percent of the firms traded in the Italian stock market have a single majority owner, compared to only 9 percent in 1986 in the United States, and 5 percent in 1983 in Japan. The largest five shareholders held, on average, nearly 90 percent of outstanding shares of listed companies in Italy (OECD, 1994–95: 60). The Italian system of corporate governance was conceived with concentrated shareholders as a group, and this continues to be trend in the 1990s as shown in Table 2.11. In the 1990s, there was a small change in the corporate control of large

Table 2.11 Ownership concentration of Italian listed companies as percentage of total market capitalization[a]

	1996	*1997*	*1998*	*1999*	*2000*
First shareholder	50.4	38.7	33.8	44.2	44.0
First three shareholders	59.6	44.8	40.8	50.1	50.9
Market	38.9	52.9	56.5	47.6	46.6

[a] As a % of total capitalization of ordinary shares of all firms quoted in the Italian stock exchange.
Source: Consob (2001: 7).

Italian corporations due to the massive privatization and consequent ownership reorganization during 1997 and 1998 that led to a temporary trend of diffusion of ownership, and the successive process of control reorganization that led to an increasing ownership concentration. As is shown in Table 2.11, the ownership concentration changes during the last five years are explained mostly by the percentage of ownership held by the largest shareholder that declined from 50.4 percent in 1996 to 33.8 percent in 1998 to increase again in 1999 to 44 percent (Consob, 2001: 7). In fact, Consob reports a stable ownership concentration rate for nonstate quoted firms that was not susceptible to the process of privatization. Thus, among the nonstate-owned firms that were listed in the Italian stock exchange during the 1990–2000 period, the average percentage ownership of the first shareholder has remained substantially unchanged with a value around 50 percent of total market capitalization (Consob, 2001: 9). In sum, high ownership concentration continues to be the main pattern of Italian corporate control where in 2000, the ownership percentage of the largest shareholder accounts for over 50 percent of ordinary capitalization for 141 firms out of the 237 quoted in the Italian stock exchange (Consob, 2001: 122).

The Italian single majority shareholder phenomenon can take several forms. Among small firms, it is typical to find absolute control by an individual (often the founder) who holds a majority of voting rights. According to Barca (1996), this control model accounts for approximately 9 percent of the activity of manufacturing firms with more than 50 employees. The ownership of quoted Italian firms is concentrated around three main models of corporate control: families, coalitions, or the state.

Ownership concentration of listed firms is usually explained by the fact that the main shareholder acts as a *blockholder*. This form is referred to as "pyramided" holding, Chinese boxes, or hierarchical group control. It is estimated that one-third of Italian firms are controlled in this fashion. A pyramidal group is formed by judicially autonomous firms (that may range from two firms to hundreds) controlled by the same entrepreneur via a chain of proprietary and control relations that are vertical and unidirectional (Brioschi et al., 1990; Zattoni, 1994; Barca, 1996; Bianco et al., 1996).

The main characteristic is that the blockholder controls directly through both equity or indirectly through the nonvoting shares and shareholder agreements the majority of the firm's voting rights (Melis, 2000: 348). "Upstream" firms along the chain of control directly own majority stakes in "downstream" firms which accounts for the high concentration of ownership in pyramidal groups. There exists a single strong shareholder at the top of the pyramid.

> The remaining members of the controlling group, in turn, are normally large or controlling shareholders of other companies and are sometimes involved in related industries. Shared control and minority holdings, when significant and part of a broader agreement, tend to form webs of stable inter-firm relationships. Such relationships, however, remain mostly one-directional: the law confines cross-ownership to small percentages of the capital, and a circular ownership, although not expressly prohibited, faces some obstacles. (Stranghellini, 1995: 144)

Pyramidal groups are used as a device by blockholders to retain huge corporate control of capital though spreading the voting rights of minority shareholders over a large number of firms, with little direct ownership, and dispersed risk.

Pyramidal groups are intended to allow greater separation between ownership and control, and their spread goes hand in hand with the absence of specific regulations to safeguard the interests of minority shareholders in subsidiaries. The pyramidal pattern is transforming as the rest of the economy. The average number of quoted firms in Italy that formed the top ten nonstate pyramidal groups was seven in 1990 versus three in 2000. The concentration of corporate control of pyramidal groups is illustrated by the average separation (capital under control/capital owned) which has been reduced 25 percent among the top ten nonstate pyramidal groups in the period 1990–2000 (from 2.4 to 1.8) (Consob, 2001: 8–9).

The use of nonvoting shares, an important device in the corporate governance of pyramidal groups, has also diminished from being used in 40 percent of total firms quoted in 1990 to 25 percent in 2000. Thus, the capitalization weight of nonvoting shares over total market share capitalization decreased from 14 percent in 1990 to 4 percent in 2000 (Consob, 2001: 8–9). In contrast, shareholder agreements, another mechanism to maintain the control of the company by a coalition of blockholders (Melis, 2000: 350), have increased despite the Draghi reform intended to weaken them. According to Consob (2000: 6), at the end of 1999 there were 70 listed companies – as opposed to 56 and 65 in 1996 and 1998 respectively, representing 32 percent of the total market capitalization of the Italian stock exchange. "The holdings involved in these agreements [in 1999] were equal to around 50 percent of the company's ordinary share

capital on average and their market value was equal to 12.9 percent of total market capitalization of the Stock Exchange" (Consob, 2000: 6). There has, however, been a slight decrease in the percentage of share capital covered by shareholder agreements from 15.9 percent in 1996 to 12.9 percent in 1999 (Consob, 2000: 7).

Controlling owners at the top of a pyramidal group are either families, coalitions, or the state. A study of the pyramidal groups among Italian quoted firms in 1993 by Barca et al. (1994) shows that attributing control of the company at the top of the pyramidal group, to all companies of the group, 40.7 percent of the firms have family control, 18.8 percent coalition control, and 15.2 percent state control.

"Family control" is widely represented by family groups that illustrate the predominance of family-run business in the Italian economy (Bianco et al., 1996: 19). Shareholders in this model are usually the firm's founders or families of the founders also highly involved in the day-to-day management duties of the firm. Noncontrolling investors come from family links and are based on trust relationships. There is limited separation between ownership and control and strong barriers against growth, which tends to be limited by the size of existing families. This model enter into crises due to generational succession and the need for further corporate financing. "Coalition control" as in the family control model entails a trust link between entrepreneurs and investors – often through contractual or implicit shareholder agreements – and a trust based on shared values or economic experiences. This is also the case of the well-known *industrial districts*, the corporate networks among small and medium-size enterprises (Best, 1990; Pyke et al., 1990; Weiss, 1984). Finally, "state control" played a crucial role up to the mid-1990s when the government controlled a major stake in large state-owned enterprises and also allocated resources to private ailing firms. This model is tightly linked to the political environment in Italy, though it is slowly changing with the privatization process.

Table 2.11 shows that ownership concentration in Italy has decreased since 1996, although still highly concentrated, and it is certainly almost impossible to exercise corporate control measures typical of dispersed firms in Anglo-Saxon markets.

2.4.4 The role of banks

The financial model of control is basically absent in the Italian corporate scenario. A distinguishing feature of the structure of corporate ownership in Italy is the minor role played by financial institutions. When contrasted with other Continental European countries, we observe that financial institutions are not highly involved in the corporate monitoring of Italian listed firms. Although banks have a relevant stake in corporate external financing (Ciocca, 1991, 2000; Capra et al., 1994), due to the historical weak relationship between banks and industry, they do not participate in corporate governance (Capra et al., 1994). The role of banks in Italy explains why this is the case. The 1936 Banking Law enforced the separation between banking and industry introduced by (1) prohibiting banks from holding equity participation in industrial firms, and by (2) drawing a sharp division between commercial banks (specializing in short-term lending), and investment banks (specializing in long-term lending). This law was similar to the American Glass–Steagal Act, although as Magnani and Trento (2001) point out, it was never intended to relaunch the stock market and obtain a broader ownership base.

The prevalence of the 1936 Banking Law until 1993[10] banished the existing universal banks, and prevented the development of strong bank–industry relations (Zamagni, 1993; Bianco and Trento, 1995). Banks are generally not involved in the economic activities or auditing of corporate performance of their clients. Mixing of industry and financial corporations can only be found in the pyramidal groups. One of the main activities of Italian banks is lending to nonfinancial firms rather than holding stakes in nonfinancial corporations. However, long-term credit to nonfinancial corporations can only be provided by two special credit institutions or *merchant banks* (IMI and Mediobanca), and therefore short-term credit represents the dominant form of financial investment in nonfinancial firms by banks. Table 2.12 shows that in the 1990s short-term lending represented nearly 90 percent of the lending undertaken (mainly through bank affidavits and also checking-account overdraft facilities), while long-term lending accounted for merely 10 percent.

Another feature of the Italian banking system is its relatively small size (OECD, 1994–95: 73) and low concentration (Conigliani, 1990). A high number of banks survive because multiple bank lending is a common practice in Italy. According to Barca (1996: 8), firms with total debt higher than 1 million lire in 1992 borrowed from an average of five banks per firm. Borrowing from multiple banks allows industrial corporations to multiply their financing opportunities and decrease their level of dependency and corporate transparency, while banks diversify risk (Ceola et al., 1994; Bragantini, 1996). There is no evidence of bank monitoring of corporate performance due to short-term lending, the high turnover of

Table 2.12 Bank lending to nonfinancial enterprises in Italy (% of total loans)

Year	*Total loans (billion lire)*	*Short term*	*Long term*
1990	448,219	90.0	10.0
1991	516,370	89.6	10.4
1992	591,977	89.1	10.9
1993	632,416	88.6	11.4

Source: OECD (1994–95: 76).

bank–customer relations, firms enjoying multiple credit lines, and the wide use of collateral. In addition, "banks have in general preferred an arm's-length relationship with their customers to relational financing: while minimizing their irreversible investments in stable, long-term customer relationships, they have relied on the opportunity to discontinue credit to their clients or to forfeit their personal wealth" (Barca, 1996: 9). In this financial context, banks have traditionally developed little know-how in corporate finance, and no other financial institution (for example investment banks, fund managers, or accounting houses) has replaced the role of banks in the ownership structure and become active in the Italian economy. Initially, the state took over the banks, but the absence of other financial institutions such as pension funds is partly explained by the country's broad-coverage, pay-as-you-go pension system.

During the 1990s, partly as a result of the new 1993 Banking Law as well as the liberalization of the banking sector, Italian banks have started to merge and work to establish a national presence. Table 2.13 shows the number of banking mergers and the significant increase in the merger rate since the early 1990s, and Table 2.14 indicates the concentration in the Italian banking sector by size and how their loan composition directly related to the size of the bank.

The main exception to the eradication of the bank–industry relationship was the investment bank, Mediobanca, formed in 1946 with equity capital from three IRI banks: Banca Commerciale, Credito Italiano, and Banca di

Table 2.13 Number of bank mergers in Italy, 1980–97

1980	7
1981	8
1982	8
1983	11
1984	6
1985	9
1986	12
1987	12
1988	21
1989	22
1990	23
1991	48
1992	48
1993	42
1994	52
1995	56
1996	44
1997	34

Source: De Bonis and Ferrando (2000: Table 6, p. 28).

Table 2.14 Italian banks by size and composition of loans

	1989	*1992*	*1995*	*1998*
Large banks				
Number	26	25	24	24
Branches	6,426	9,132	11,464	12,566
Average total assets (billion lire)	35,095	49,995	63,684	72,730
National loan market share(%)	57.0	58.4	59.8	59.2
Loan composition(%)				
Large nonfinancial firms	42.9	42.9	43.2	41.6
Small and medium nonfinancial firms	26.5	24.1	25.9	23.1
Other borrowers	30.7	33.0	31.5	35.3
Medium-sized banks				
Number	40	39	36	32
Branches	2,742	3,356	3,964	4,484
Average total assets (billion lire)	7,480	10,533	13,963	16,564
National loan market share(%)	21.1	20.7	21.6	19.8
Loan composition(%)				
Large nonfinancial firms	42.4	44.9	44.8	47.9
Small and medium nonfinancial firms	32.6	30.1	30.4	28.7
Other borrowers	25.0	25.1	24.8	23.4
Small banks				
Number	1,057	1,000	912	862
Branches	6,401	7,523	8,210	9,577
Average total assets (billion lire)	408	562	718	979
National loan market share(%)	21.9	20.9	18.6	20.9
Loan composition(%)				
Large nonfinancial firms	31.2	32.9	32.1	34.5
Small and medium nonfinancial firms	45.5	43.9	46.9	43.5
Other borrowers	23.2	23.2	21.0	22.0
Total banks				
Number	1,176	1,073	970	921
Branches	15,569	20,011	23,638	26,627
Average total assets (billion lire)	1,462	2,086	2,802	3,365
Loan composition(%)				
Large nonfinancial firms	40.6	41.6	41.7	41.8
Small and medium nonfinancial firms	31.3	28.8	29.7	27.6
Other borrowers	28.1	29.6	28.5	30.5

Source: Bonaccorsi di Patti and Gobbi (2001), Table 2 from *Italian Central Credit Register and Bank Supervisory Reports*, p. 27.

Roma. This bank replicated the universal bank role for Italy's leading private firms, guaranteeing their stability and growth, and helping them in times of crisis (De Cecco and Ferri, 1996). Mediobanca led Italian capitalism. It was at the center of a web of directorship interlocks (Aguilera, 1999) and influences, thanks to its stakes in the main Italian financial and industrial groups and its well-connected shareholders, the so-called Milan *salotto*

buono. Up to the end of the 1990s as *The Economist* puts it, "this small and secretive bank was the pre-eminent power in Italian finance" (June 23, 2001: 82–3). More recently, mostly due to financial deregulation and the privatization process, international investment banks have settled and expanded in the Italian financial market and Mediobanca's influence seems to have declined, leaving it appearing smaller, parochial, and often left behind in the main Italian financial operations. For instance, Mediobanca, relative to international investment banks, benefited little from privatizations. In addition, unlike international investment banks that headed the lists in Italian merger and acquisition operations, it ranked only sixth according to Morgan Stanley or tenth according to Rothschilds (*The Economist*, June 23, 2001: 82). Mediobanca's future role is therefore in question.

2.4.5 Stock market

Italy has a relatively small stock market that has played a minor role in Italian corporate governance. It has traditionally been described as lacking transparency, efficiency, and depth. As Table 2.15 confirms, in the 1990s there were fewer than 300 Italian companies listed and regularly traded on the Italian automated stock exchange whose administrative and operating headquarters are in Milan. In May 2001, the number increased to 352 mostly due to privatization patterns (FIBV, 2001). Table 2.16 shows that in 1996, the total capitalization of the Italian stock exchange was about 21 percent of the GDP, a percentage substantially lower than in most other OECD countries, especially Anglo-Saxon countries. Economic and institutional factors have restricted the development of the Italian stock market. According to the OECD (1994–95: 82), "besides the fear of losing control, entrepreneurs are reluctant to go public because underpricing in Italian initial public offerings is particularly high". In addition, from the small investor side, minority shareholder rights have been rudimentary, favoring the few large shareholders (Bianchi et al., 1998).

The state stunted the growth of the stock market by offering one of the largest bond markets in Europe, and the third largest in the world. This resulted in a *crowding out* effect, and one of the highest European government debts. This is particularly notorious in Italy where the government percentage of total bonds in 1997 was 83.5 percent (OECD, 2000: 86).

Despite the Italian stock market's minor role in the economy, the number of listed companies in Italy has followed a steady increase in the last 20 years and the stock market as a whole is growing. This growth is explained by several factors:

1. Approval of the Italian Stock Market Law of 1991 intended to reform the Italian public financial market under the supervision of the Bank of Italy and Consob (the supervisory agency for the public capital markets);
2. The favorable, if temporary, tax regime introduced in 1994 for companies that choose to go public (Stranghellini, 1995: 135);

Table 2.15 Number of listed domestic companies, 1989–2000

	1989	1991	1997	1998	1999[a]	2000[a]		
						Domestic	Foreign	Total
Australia (Assoc. of SE)	1,258	957	1,219	1,162	1,287	1,330	76	1,406
Austria (Vienna)	81	105	101	96	144	97	14	111
Belgium (Brussels)	184	183	138	146	278	161	104	265
Canada (Toronto)	1,146	1,086	1,362	1,384	1,456	1,379	42	1,421
Denmark (Copenhagen)	257	261	237	242	242	225	10	235
Finland (Helsinki)	78	63	124	129	150	154	4	158
France (Paris)	668	551	683	711	969	808	158	966
Germany (Assoc. of SE)	628	428	700	741	851	744	245	989
Italy (Milan)	**217**	**224**	**235**	**320**	**270**	**291**	**6**	**297**
Japan (Tokyo)	2,019	2,107	2,387	2,416	1,935	2,055	41	2,096
Netherlands (Amsterdam)	313	204	201	212	387	234	158	392
New Zealand	242	139	190	135	189	144	56	200
Norway (Oslo)	122	112	196	236	215	191	24	215
Spain (Madrid)		**433**	**384**	**484**	**727**	**1,019**	**17**	**1,036**
Sweden (Stockholm)	135	230	245	258	300	292	19	311
Switzerland (Zurich)	177	182	216	232	412	252	164	416
Turkey (Istanbul)	50	134	257	277	286	315	1	316
United Kingdom (London)	2,015	1,623	2,046	2,399	2,274	1,926	448	2,374
United States (NYSE, AMEX and NASDAQ)	6,727	6,742	8,851	8,450	8,504	7,274	971	8,245

[a] 1999 and 2000 data are from *Fédération Internationale des Bourses de Valeurs* (FIBV), Table 1.1, www.fibv.com.
Source: IFC, *Factbook* (1999), *Emerging Markets Data Base*, p. 23.

3. The increasing internationalization of capital markets, and primarily
4. Privatization of state-owned companies initiated in 1992.

In 1998, the volume of trading in the ordinary shares of privatized companies accounted for around 34 percent of the Italian stock market total (Consob, 2000: 12). Reform initiatives by the Consob and the Bank of Italy led to the enactment of a new law for listed companies in 1998: the Draghi reform (Legislative Decree, February 24, 1998, n. 58). This reform fostered the rights of minority shareholders by regulating listed companies on issues such as shareholders' agreements, internal controls, and public bids (Melis, 2000: 348). The 1998 legal reform also encouraged more activism in the Italian stock market, and maybe empowered minority shareholders by providing them some tools to discipline managers. Recent data demonstrate that the pattern of capital market development continues: Italian market capitalization of shares of domestic companies increased 12.6 percent between 1999 and 2000 (FIBV, 2001), and in 2000 market capitalization of

Table 2.16 Market capitalization of listed domestic equity issues at year end in selected OECD countries (% of GDP)

	1975	*1980*	*1985*	*1990*	*1993*	*1994*	*1995*	*1996*
Australia (Assoc. of SE)	22	40	37	37	71	67	70	80
Austria (Vienna)	3	3	7	17	16	16	14	15
Belgium (Brussels)	15	8	26	33	37	36	37	44
Canada (Toronto and Vancouver)	30	45	45	43	61	59	66	86
Denmark (Copenhagen)	11	8	26	30	31	34	33	41
Finland (Helsinki)	–	–	11	17	28	39	35	49
France (Paris)	10	8	15	26	36	34	33	38
Germany (Assoc. of SE)	12	9	29	22	24	24	24	28
Italy (Milan)[a]	**5**	**6**	**14**	**14**	**15**	**18**	**14**	**21**
Japan (Tokyo)	28	36	71	99	68	77	69	66
Netherlands (Amsterdam)	21	17	47	42	58	67	72	95
New Zealand	–	–	39	20	56	53	53	56
Norway (Oslo)	–	–	16	23	24	30	30	36
Spain (Madrid)	–	**8**	**12**	**23**	**25**	**25**	**27**	**33**
Sweden (Stockholm)	3	10	37	40	58	66	75	95
Switzerland (Zurich)[b]	30	42	91	69	114	109	129	136
Turkey (Istanbul)	–	–	–	–	20	17	12	17
United Kingdom (London)	37	38	77	87	122	114	122	142
United States (NYSE, AMEX and NASDAQ)[c]	48	50	57	56	81	75	98	114

[a] Italy – all Italy on a net basis since 1985.
[b] Switzerland – only Zurich throughout 1990.
[c] United States – including foreign shares in 1975.
Source: OECD (1998: 18).

the Italian stock market represented 65 percent of GDP (Magnani and Trento, 2001: 24).

2.4.6 Corporate financing

Corporate financing is an important determinant of corporate governance since it varies considerably across countries and it is a spinoff of the role of banks and stock markets (Zysman, 1983; Berglöf, 1990; Edwards and Fisher, 1994; Steinherr and Huveneers, 1994; Fukao, 1995; OECD, 1995). Several factors ranging from fiscal distortions and regulatory constraints to the features of corporate structure and control characterize Italian corporate financing. As a result of the difficulty of raising bank capital, Italian companies have relied on self-financing as a primary source of financing, followed by high levels of borrowing that enjoy a preferential fiscal treatment over equity, and on fiscal evasiveness (Bianco and Trento, 1995). Equity issues are a minor source of financing, even in listed firms (Melis, 1999). This corporate funding strategy is consistent with the political control of blockholders and with preventing threats from investors. Moreover, the highly

interventionist Italian state often described as *pervasive* (Bianco et al., 1996: 6), has not prompted the need to develop alternative financial sources.

By studying the different types of corporate financial sources, we can better understand a firm's financial dependence. A study by the OECD on the Italian corporate financial structure between 1989 and 1992 states that 50 percent of the total financial resources come from self-financing, around 43 percent from debt, and 5 percent from equity issues (OECD, 1994–95: 70). Another study of 300 Italian small and medium industrial companies (between 20 and 500 employees) in 1993 offers further evidence on the patterns of financing sources (see Table 2.17) (Barca et al., 1994). Table 2.17 shows that 83 percent of financing comes from internal sources. These are to an extent composed of personal and family resources (22 percent), but the great majority come from the sale of assets and self-financing (61 percent). Externally financial resources represent a much smaller fraction of financing (17 percent), with bank debt being a main contributor. Italian firms, particularly small and medium ones, are reticent to use the stock market as a financing tool which leaves some vulnerable to acquisition.

From a comparative perspective, two illustrative indicators of a country's corporate financing are (1) the degree of reliance on debt and equity financing, and (2) the pattern of banks' on-balance-sheet lending versus direct intermediation through securities markets. Table 2.18 reveals that leverage ratios (debt/equity ratios) in Italy are higher than in other OECD countries, with the exception of Japan. This characteristic corporate funding is also discussed by Guatri and Vicari (1994). The high leverage ratio in Italy is explained by several factors. First, public authorities may be involved as financial sources, either directly as owners or indirectly via financial institutions. Second, the existence of underdeveloped debt security markets deflects the reliance on equity issues. And third, countries with small and medium-sized companies tend to have greater leverage ratios. As in Japan and Germany, corporate debt consists mainly of high levels of borrowing from banks, yet a distinguishing feature of Italian corporate financing is the wide recourse to multiple short-term bank loans, the

Table 2.17 Corporate finance resources for 300 Italian small and medium firms in 1993 (as a % of total financial resources)

Internal sources	83.0
Personal or family	22.4
Sales of assets or self-financing	60.6
External resources	17.0
Equity issue	6.7
Bank debt	9.9
Other debt	0.4

Source: Barca et al. (1994: Vol. 1).

Table 2.18 Debt/equity ratios of nonfinancial enterprises at book values, OECD countries

	1980	*1985*	*1992*	*1993*
Belgium	2.67	1.91	1.54	1.46
Canada	0.76	0.81	0.97	0.99
Denmark	1.73	1.36	1.27	1.19
Finland	4.01	2.57	1.73	1.76
France	2.13	3.44	1.36	–
Germany	1.75	1.53	1.52	1.57
Italy	–	**3.11**	**3.24**	**3.36**
Japan	5.15	4.40	3.92	3.88
Netherlands	1.34	1.32	1.27	–
Norway	3.98	4.08	2.79	–
Spain	–	**1.65**	**1.59**	**1.63**
Sweden	2.08	1.87	2.02	–
United Kingdom	–	1.03	–	–
United States	0.46	0.60	1.04	1.03

Source: OECD (1995: 15).

virtual absence of securitized debt, and the lack of bank stakeholders. Table 2.19 shows that comparatively the percentage of bank debt over total debt for large firms is 27.3 percent, half that of Spain and three times that of the US.

In sum, Italian enterprises continue to find it easier to resort to debt financing than to expand the number of shareholders, the result being that Italian firms tend to have highly leveraged and bank-dependent capital structures. The latter is particularly true for unlisted companies. In 1992, the average debt/equity ratio for the largest 152 private Italian groups was close to 3 : 1 (*Mondo Economico*, December 25, 1993: 251).

2.4.7 Institutional investors

The increasing role of institutional investors is a pattern of the 1990s in many Anglo-Saxon countries as well as in countries like France. Institutional investors have traditionally represented a small fraction of ownership and possessed a minor role in countries where pensions are provided by the state. The small stake in nonfinancial corporations in Italy held by institutional investors is concentrated in insurance companies and mutual funds. According to an OECD survey, "their role in monitoring corporate performance is extremely passive, since they have small shareholdings and are often owned by the industrial and banking groups representing the bulk of stock market capitalization. Regulatory constraints on proxy voting further limited their role in shareholders' meeting" (OECD, 1994–95: 79). However, the role of institutional investors has more than doubled since 1992, as shown in Table 2.20. This is explained by the introduction of financial market reforms and as part of the emerging institutional investor capitalism trend initiated in the US and the UK with highly diversified portfolios.

Table 2.19 Bank debt as percentage of total debt in 1998

	Small and medium-sized firms	*Large firms*
Belgium	46.5	50.1
France	48.8	21.3
Germany	57.4	29.9
Italy	**66.4**	**27.3**
Netherlands	54.9	35.9
Spain	**66.5**	**50.4**
US	40.9	7.9

Source: Bonaccorsi di Patti and Gobbi (2001: Table 1, p. 26).

Table 2.20 Financial assets of institutional investors (as % of GDP)

	1990	*1992*	*1994*	*1996*	*1997*
Greece	6.5	8.5	18.8	28.5	–
Hungary	–	2.5	3.7	5.7	–
Luxembourg	926.8	1630.5	2170.2	2310.4	–
UK	114.5	115.3	149.3	193.1	–
Poland	–	–	1.9	2	4
Mexico	8.8	5.6	3.5	4.5	4.7
Portugal	9	17.3	31.9	34.4	31.7
Korea	48	52.3	57.5	57.3	37.2
Italy	**13.4**	**18.5**	**32.1**	**39.9**	**53.2**
Spain	**16**	**22.8**	**36.4**	**45.4**	**56.1**
Germany	36.5	33.7	44.1	49.9	57.5
Japan	81.7	78.1	84.8	77.6	75.3
France	54.8	60.5	75.6	83.1	90.6
Switzerland	119	119.4	148.6	152.4	92.7
Netherlands	133.4	132.8	157.7	169.1	183.8
US	123.8	141.3	149.7	181.1	202.8

Source: OECD (1998) *Institutional Investors, Statistical Yearbook*.

2.4.8 Summary of Italy

In sum, Italian corporate governance is characterized by high ownership concentration, little political separation between ownership and control, the legacy of legal constraints on bank ownership, and primary corporate control in the form of pyramidal groups, either family-owned or coalitions, and state ownership. The most striking feature is that there is no mechanism of inside (banks) or outside (markets) corporate control.

2.5 Corporate governance in Spain

Spain's industrial structure is similar to Italy's in many respects. The Spanish economy includes many small and medium-sized businesses, and a few large corporations that account for the majority of the country's GDP. Most firms are owned by the state, banks, and foreign investors. In contrast to Italy, however, family-owned large enterprises in Spain are not as predominant. In particular, since the Spanish entry into the European Union (1986), foreign capital has come to control an increasing proportion of business in Spain (Salmon, 1995: 36). For instance, the Spanish auto industry, Europe's third biggest, is entirely foreign-owned.

The Spanish economic structure has unfolded in historical circumstances that include the legacy of an autarkic and interventionist government, international economic pressures to develop, and the harmonization policies pursued by the European Union. In this section, I discuss the main features of corporate governance in Spain.

2.5.1 Corporate law and type of corporations

Legally, the internal structure of the Spanish corporation consists of shareholders, directors, and executive officers. The Commercial Law provides for one or more directors to represent and manage the affairs of the company.

The Spanish corporate law is based on the 1885 Commercial Code, and it has been updated with multiple laws (Sánchez-Calero, 1982; Uria, 1991). There are three main types of corporations: the Sociedad Anónima, SA (stock company), the Sociedad Limitada, SL (limited liability company), and Sociedad en Comandita or Sociedad en Comandita por Acciones, SC (limited partnership company or limited partnership with shares company). The SA structure is the most common type among large Spanish firms, and is strictly regulated under the 1989 Law of Sociedades Anónimas. The internal structure of an SA which consists of shareholders, directors, and executive officers has specific economic consequences for the firm (Arruñada, 1990). The SL, often found in small or family-owned businesses, "has a fixed capital, divided in equal parts which are cumulative and indivisible and are represented as non-negotiable instruments. The number of other members may not exceed 50 and their liability is limited to the extent of their contributions" (Fabregat and Bermejo, 1990: 54). Finally, SC constrains the liability of partners to the extent of their investment in the partnership. This legal form of corporation is suitable for groups of professionals.

2.5.2 Type of corporate ownership

The main shareholders of Spanish listed companies in the 1990s are family groups, banks, foreign companies, and the state. As shown in Table 2.8, in 1996 among these different types of owners, the primary shareholders are foreign institutional investors (28 percent) closely followed by individuals and family groups (24 percent). The high percentage of foreign ownership of Spanish corporations is mostly due to the openness of the economy after 1986. The high percentage of bank ownership relative to other OECD countries is also notable. As will be discussed later, this is a legacy of the historical economic development of Spain and the very particular role of banks.

The 1988 Law on Capital Markets introduced more flexibility into the capital markets which had led to a gradual change in the composition of shareholders in the stock market. Table 2.21 shows the decline over time in the ownership percentage of banks and the state, and an increase in institutional investors, foreign capital and individuals. The most remarkable transformations in the 1990s were the small representation of the state that in 1989 controlled 14 percent of Spanish market capitalization, while in 1999 is barely existent (0.3 percent), the increase in foreign ownership, and consequent decrease in domestic ownership (Galve and Salas Fumás, 1992). According to recent CNMV (2000: 59) data, foreign capital and families/individuals controlled 36.5 percent and 34.1 percent respectively of Spanish market capitalization in 1999. In addition, there is a small decrease in the overall percentage of institutional investors with respect to 1998, and a considerable increased role of nonfinancial firms such as Terra Networks.

2.5.3 Corporate control

In a comparative perspective, Table 2.10 indicates that Spain is among the countries with the highest ownership concentration, along with Italy, France, and Germany. In 49 percent of the firms quoted in the Spanish stock market in 1990, the largest owner has more than 50 percent of the capital. This percentage contrasts with only 9 percent in the US in 1986, 5 percent in Japan in 1983, and 2 percent in the UK in 1976.

Table 2.21 Significant shareholdings in listed Spanish companies(%)

	1992	*1994*	*1996*	*1997*
Banks	15.56	15.09	14.06	12.66
Insurance firms	3.37	2.68	2.20	2.60
Domestic institutional investors	**1.65**	**3.04**	**5.02**	**7.55**
State	16.64	13.77	10.87	5.57
Nonfinancial firms	7.72	6.80	6.90	5.58
Individuals	24.44	22.76	23.59	28.73
Foreign	30.61	35.86	37.36	37.31
Total	100	100	100	100

Sources: Bolsa de Madrid; Eguidazu (1999: 256–7).

Table 2.22 demonstrates that ownership concentration is very high among publicly traded companies in Spain, where firms are often under absolute or majority control. In the 1990s, the percentage of corporations in which the three largest shareholders hold more than four-fifths of the control has increased from 13 to 17 percent. Roughly 55 percent of the firms in the Spanish stock market in 1995 are majority-controlled (that is, the largest three shareholders held at least half of the capital of these corporations). Table 2.23 shows ownership concentration for the largest shareholder in 1997, and the main conclusion remains that there is little room to change corporate control, as in almost half of the firms in the market (48.9 percent) representing 20.6 percent of market capitalization, the largest owner is a majority owner.

2.5.4 The role of the banks

Historically, Spanish banks have been privileged by the state, concentrated, and extremely protected against competition from foreign banks (Velarde, 1969; Muñoz, 1970; Tamames, 1977; Tortella and Palafox, 1984). The state, through the Bank of Spain, encouraged bank-led industrialization, and as a result the "big banks" performed as mixed or universal banks. They were debt-holders and shareholders of industrial corporations, particularly in economic sectors defined as key for Spanish economic development (Lukauskas, 1994; Tortella, 1994; Pérez, 1997). Bank competition was limited and it was difficult to establish new domestic banks, because the

Table 2.22 Ownership percentage among the first three shareholders (k3) for Spanish quoted firms

Type of control of three main shareholders	*1991*	*1992*	*1993*	*1994*	*1995*
Absolute control (k3 < 80% capital)	12.92	13.75	16.25	17.92	17.08
Majority control (50% < k3 > 80%)	40.00	38.75	41.67	37.08	37.92
Minority control (5% < k3 > 50%)	38.75	41.25	35.42	39.17	37.92
Internal control (k3 < 5%)	8.33	6.25	6.67	5.83	7.08

Sources: Cuervo-Cazurra (1997) from 240 firms; CNMV (2000: 83).

Table 2.23 Likelihood of corporate control change among Spanish quoted firms, 1997

% of ownership of first shareholder	*No. of firms(%)*	*Market capitalization(%)*	*Corporate control change*
Less than 25	25.1	66.2	Possible
Between 25 and 50	26.0	13.2	Impossible
More than 50	48.9	20.6	Impossible

Source: CNMV, *El País* (June 18, 2000).

few dominating banks enjoyed a status quo position. The establishment of foreign banks in Spain was not allowed until 1978,[11] and even then foreign banks experienced great difficulties in entering retail banking.

Banks have been the only financial institution in Spain during much of its economic development, and therefore played a key role in corporate governance up to the 1990s, as discussed above. They are divided into state-owned banks, commercial banks, and savings banks. Savings banks, unlike the other two types, do not participate in industrial holdings, instead they are oriented to family savings and occasionally to small business customers. In contrast to many other legal systems, there are no restrictions on the participation of commercial and state-owned banks in nonbanking business. In 1993, banks held 13 percent of the shares of quoted firms, but they were also prominent debt-holders or financial intermediaries.

In the last 20 years, the banking scenario has been modified by mergers among the largest banks,[12] and the two largest banks (BSCH and BBVA) have undertaken an aggressive process of acquisition of smaller banks. Thus, while in 1990, the eight largest Spanish banks controlled 50.5 percent of market share, by the end of 2000, the four largest Spanish banks controlled 54 percent (with the two largest controlling 38 percent) (*El País*, June 10, 2001: 10). This banking concentration allowed Spanish banks to become more internationally competitive and to be able to cope with the entry of a few strong foreign banks. Moreover, financial services in Spain are in the midst of important reorganization due to the necessity to adjust Spanish banking regulations to conform with the Second Directive on Banking from the European Union, as well as the banks' interest to develop alternative financial interests with the liberalization of capital movements, the internationalization of financial markets, and other financial innovations.

2.5.5 Stock market

Historically, the Spanish stock market resembles the Italian one. It did not take off until the Capital Markets Law of 1988 which provided a modern regulatory framework. This law aimed to activate the stock market, by providing more protection to stakeholders as well as to increase transparency in stock market operations. It founded a supervisory institution, the National Securities Exchange Commission (Comisión Nacional del Mercado de Valores, CNMV), that is governed by a board appointed by the government. There are four stock exchanges in Spain (Madrid, Barcelona, Bilbao, and Valencia) that are traded continuously. The Madrid stock exchange is the largest one: it represents 97.7 percent of the capitalization, and 85 percent of the trade in 1998. The stock exchange has traditionally been narrow with only a few hundred companies quoted in the Madrid stock exchange in 1970s, surpassing 1000 in 2000 as shown in Table 2.15.

By 1992, market capitalization had increased tenfold since the early 1970s (Tamames, 1993: 461). Market capitalization of listed firms as a percentage of GDP was under 10 percent before the mid-1980s as indicated in Table 2.16, but since then it has accelerated rapidly, reaching over 30 percent in 1995, and up to 69 percent in 1998 (Torrero, 2001: 84). The main triggers of change have been economic prosperity, Spain's entry into the European Union, the rapid process of privatizations, and the emergence of investment funds.

The Spanish stock market has grown immensely as is shown in Table 2.15, surpassing the marking capitalization and number of quoted companies of Italy. Part of this high rate is due to the high level of foreign capital participation in the Spanish stock market compared to the Italian, as shown in Table 2.21. However, the Spanish stock exchange still trails those in many other OECD countries; it remains narrow and lacks transparency. Two features of its backwardness are the concentration of a high percentage of market capitalization in a few companies, and the failure of the industrial sector to reflect the real economy distribution. The top 10 companies out of the 125 in the Madrid Index accumulate 66.56 percent of the index's total capitalization, and the industrial distribution of banks, electric companies and the Spanish telecommunications firm, recently privatized, Telefónica accounts for 80 percent of the Madrid Index (Torrero, 2001: 87–9).

2.5.6 Corporate financing

In Spain, banks have traditionally played a key role due to the underdevelopment of capital markets and difficulty of foreign financing. Thus, the primary sources of Spanish corporate financing are self-financing and bank debt (Costa, 1996: 291; Salas Fumás, 1991). When comparing the Spanish case to other OECD countries as exhibited in Table 2.18, it is noticeable that the Spanish leverage ratio (debt/equity ratio) in 1993 is high (1.63), but not nearly as high as in Japan (3.88) or Italy (3.36). This is due to the fact that Spanish banks are often part of large industrial holdings, and the Spanish industrial corporations usually do business with only one bank that in turn owns shares in the firm. Unlike Italian banks, Spanish banks tend to be involved in and informed of the economic and strategic activities of their nonfinancial clients.

Table 2.24 describes corporate financing patterns for Spanish manufacturing firms for the period 1983–92. It shows a decrease in bank debt over total debt, compensated by an increase in financial autonomy. Bank debt has decreased from 54 percent in 1983 to 33 percent in 1992, and debt over liabilities has also decreased from 72 percent in 1983 to 64 percent in 1992, according to Bank of Spain data (Genesca and Salas, 1995). However, an international comparison of bank debt over total debt shows that Spanish firms (both small and medium-sized firms and large firms) still rely heavily on banks for their corporate financing, as shown in Table 2.19. The recent OECD (2001: 21) country report on Spain states that Spanish firms have increased their indebtedness, and given the turbulence on stock markets, debt/equity ratios have risen.

2.5.7 Institutional investors

In general, the involvement of institutional investors in the Spanish financial scene is limited. Investment funds are the main institutional investors in Spain. These do not influence the financial market much because their holdings are mostly composed of fixed-interest-bearing bonds *(activos de renta fija)*. Cals and Garrido (1999) point out the minor involvement of institutional investors in Spanish corporate financing, despite the rapid emergence of institutional investors as shown in Table 2.20. They also highlight the importance of foreign investment in the Spanish stock market. Foreign capital institutional investors have driven the stock exchange since 1985, with banking, electricity, construction, and chemistry being the economic sectors that have been principally targeted. An important future challenge might be public pension expenditures. As a result, governments are introducing incentives for citizens to complement public pensions with private pensions. The offering of public pensions was widely spread in the early 1990s in both Italy and Spain, but not really adopted as a saving strategy by individuals.

2.5.8 Summary of Spain

In sum, Spanish corporate governance is characterized by high ownership concentration, almost no separation between ownership and control, no constraints on bank ownership, and – since the Spanish entry into the European Union – considerable changes in the infusion of foreign capital,

Table 2.24 Corporate financial structure of Spanish manufacturing firms, 1983–92

	1983	*1985*	*1987*	*1989*	*1990*	*1991*	*1992*
Equity/total liabilities	28.06	33.88	39.04	45.09	42.10	38.99	35.58
Debt/total liabilities	71.94	66.12	60.96	54.91	57.90	61.01	64.42
Financial costs/gross	79.60	57.23	37.91	28.40	40.80	51.66	69.79
Short-term debt/total debt	68.94	69.71	72.33	73.17	72.43	70.50	68.58
Long-term debt/total debt	31.06	30.29	27.67	26.83	27.57	29.50	31.42
Bank debt/total debt	54.37	49.25	39.71	31.08	33.20	32.48	33.44
Short-term bank debt/ short-term debt	46.79	44.63	35.04	26.73	30.23	28.93	30.44
Long-term bank debt/ long-term debt	71.21	59.88	51.89	42.95	41.02	40.98	39.9

Sources: Genesca and Salas (1995: 157); data bank for the Accounts of Companies Harmonized, Central de Balances del Banco de España.

significant decrease in state ownership, and the need for financial adjustments to harmonize with the European Union.

2.6 A comparison of corporate governance in Italy and Spain. Where do Italian and Spanish corporate governance practices fit?

In this section, I explore similarities and differences in corporate governance between Italy and Spain which are shaped by the respective changing institutional environments in these two countries. I maintain a comparative perspective, reviewing these two settings relative to other countries that conform to the Anglo-Saxon and the Continental models to provide a broader picture and a thorough comparison. I will highlight six main issues that are striking in this cross-national comparison.

First, Italian and Spanish corporate laws are constructed within the tradition of the French Civil Code rather than the common law tradition of Anglo-Saxon countries. As such it appears at first glance that there are few differences between them. However, different national economic attributes such as the nature of the corporation, and the relationships of the corporation with the state and other external institutions have contributed to the development of differences in corporate law. For instance, during the 40 years of the Spanish dictatorship (1936–77), there were very few legal modifications in Spain's corporate legislation. In the democratic period (1977 onwards), several corporate laws were approved to modernize the Spanish corporate system. Italy experimented with a more turbulent pattern, marked by several economic crises such as the banking crisis in the 1930s, the inflationary episode in the 1960s, and the more recent international competitiveness that forced a change in Italian corporate legislation.

In the 1990s, the main thrust of change of company law has been provided by the directives of the European Community (now the European Union, EU), and its attempts to harmonize business practices across EU members. Nine EU directives that have been implemented between 1969 and 1993 deal directly or indirectly with corporate law. In addition, pressures to privatize the large state-owned sectors, adjust to the increasing internationalization of markets, and particularly in the case of Italy strengthen its financial system, have led to the enactment of new corporate and financial legislation.

Second, the structure of corporate ownership and control highlights the main institutions involved in corporate governance. Table 2.8 provides an overall comparative perspective on the types of ownership by showing the direct ownership of listed companies. Four observations need to be pointed out. First, among Continental European countries, Italy has a small percentage of ownership in the hands of banks. Only 11 percent of Italian listed companies are owned by banks, in contrast to 13 percent in Spain and 25 percent in France. Second, domestic nonfinancial capital in Italy is higher than the average, while in Spain it is below average. Third, foreign ownership is very prominent in Spain (28 percent), while Italy follows the trend of the Anglo-Saxon countries in that it has low rates of ownership by foreign capital (below 5 percent). Last, while state ownership is the highest in Italy, it is surprisingly low in Spain.

Third, corporate control is measured by the degree of ownership concentration. Ownership of both Italian and Spanish corporations is highly concentrated. In almost every company, publicly or privately held, there is a controlling shareholder or a group of influential shareholders tied by strong contractual relationships. Table 2.10 specifies the level of concentration in comparative terms by measuring the ownership share held by the largest shareholder of the company. We observe that in Italy in 60 percent of listed firms, the largest owner has majority stockholdings, compared with 66 percent in Germany, and 49 percent in Spain. Ownership concentration is much dispersed in the Anglo-Saxon countries (9 percent in the US and 2 percent in the UK) and in Japan (5 percent). In sum, although Italy has a higher ownership concentration than Spain, both countries are characterized by concentrated ownership patterns compared to the Anglo-Saxon model countries.

In contrast to the Anglo-Saxon model where there is more diversified ownership, most dominant or controlling shareholders of listed companies in Italy and Spain have traditionally been directly involved in the management of the company for a long time. Families of the founders (or strong individuals in the case of Italy, and banks in the case of Spain) control each company, either by themselves or jointly with other large shareholders. Members of the board of directors in Italy and Spain have fiduciary duties with respect to shareholders. However, as Melis points out (2000: 348), traditionally the expression "shareholder value maximization" in Italy is equivalent to "maximize the value for the blockholder." This usually occurs at the expense of minority shareholders.

It is common for Italian and Spanish firms to issue nonvoting shares that are risk free for the control of the company. The Italian Draghi reform effective in July 1998 attempted to introduce modifications in the *shareholder agreements* to weaken the power of blockholders (Melis, 2000). However, Becht and Röell (1999) show that the median size of the largest voting block for industrial companies in the late 1990s is 54.53 and 34.2 percent in Italy and Spain respectively. The percentage is particularly high in Italy where the gap between ownership and control is huge. Pyramidal groups are the mechanisms to gain massive voting power when owning a relatively small share of the company. Zingales (1994) and Nicodano (1998) report how the benefits of control enjoy an abnormally high premium. Finally, disclosure rules and insider trading regulation were not enforced, and proof is that of the 51 insider trading investigations

conducted by Consob in 1997–98 only one resulted in a guilty verdict (Brunello et al., 1999: 10). Table 2.23 demonstrates that an involuntary change of corporate control is only possible in 25 percent of the Spanish quoted companies due to ownership concentration. The first high profile Spanish hostile takeover attempt was in 1988 between two of the largest banks (Banco de Bilbao and Banesto). It failed. Ever since, several anti-takeover measures were introduced to prevent such controlling measures. For instance, all privatized firms in the IBEX35 (Spanish blue chip firms) have incorporated golden shares in their corporate control models which allows special owners to veto decision-making. Consequently, there have been only 111 major hostile takeovers between 1989 and 1998, 1995 and 1996 being the most active years.

A main difference in corporate control in Italy and Spain is reflected in the role of banks. In Spain, the predominant banking model is the universal bank with strong ownership ties between industry and banking. High levels of cross-shareholdings with the few existing large banks have protected managers from takeovers. Banks played a key role in the modernization of the Spanish economy during the late period of the Spanish dictatorship until the mid-1990s, by establishing exclusive, long-term debt relationships with nonfinancial firms. In addition, they monitored nonfinancial corporations by sitting on their boards (Aguilera, 1999). In the Italian case, where the legacy of the 1936 Banking Law prohibited bank ownership of industrial holdings, and separated short- and long-term lending institutions, banks do not replace the missing external markets for corporate control. The majority of Italian banks are relatively small and establish arm's-length relationships with nonfinancial corporations. Yet, there is no real financial institution substituting for the weak role of banks.

Therefore, the pattern of control in Italy and Spain leads to the conclusion that the public company described by Berle and Means (1932) and more recently by Roe (1994), where there is a sharp separation between ownership and control, does not exist in these two countries. The high ownership concentration and lack of political separation between ownership and control in Italy and Spain explain why very few companies are targets for hostile takeovers or other market mechanisms of corporate control common in the US and the UK.

Fourth, state intervention influencing corporate governance in these two countries is one of the most representative features. Up to the mid-1980s, the state was highly interventionist as an owner and saver of ailing industrial and financial firms through state industrial holdings. The liberalization and deregulation pressures from the EU led to major processes of privatization monitored by the state. However, privatized companies provide further evidence for lack of a genuine market for corporate control. There are two illustrative examples. First, the Italian and Spanish governments introduced veto power, dubbed the *golden share*, over privatized

companies of national interest which in the case of Italy include a ban on wielding more than 3 percent of a company's voting capital. Second, recent decree laws enacted in both countries limit any significant foreign ownership in the hands of the state (for example EdF) of domestic firms (Montedison) in the recently privatized energy sector.

There exists a constant trade-off between national and supranational interests because the European Commission continues its efforts to dismantle the golden share method. This is reflected, for instance, in the Draghi law attempt to impose some market corporate control among privatized firms. Hence, in Italy, this reform established that "the 3% voting ceiling under the privatization law evaporates if a formal offer for 100% of ordinary shares is made" (*Euromoney*, July 1999). Perhaps, the main exception toward an effective market for corporate control in these two countries has been Olivetti's audacious takeover bid of Telecom Italia in February 1999, with Deutsche Telekom as a white knight, the high profile involvement of Shröder and D'Alema and several Anglo-Saxon fund managers, and most importantly the exclusion of the *cozy salotto buono* (the drawing room where Italian deals have always been struck among blockholders) which brought a new reality to Italy's corporate governance scenario.

Fifth, the bulk of Italian and Spanish private industry has grown without the contribution of the public stock market, notwithstanding recent regulatory attempts to provide incentives for firms to go public and to bring more transparency to the stock market. Table 2.16 illustrates this trend toward greater market capitalization. Yet, corporate cultural factors are changing only gradually, as individuals in Spain and Italy have traditionally preferred to make their investments in personal savings or government bonds.

A new phenomenon in Europe in the late 1990s was the launching of New Markets, à la Nasdaq, reserved for small and medium-size technology companies. The first European "Nasdaq" opened in 1996 in France, the Nouveau Marché, and was followed in 1997 by Germany's Neuer Markt, Euro NM Belgium and Euro.NM Amsterdam. In 1999, Italy and the UK caught up with the New Market, launching Nuovo Mercato and Techmark respectively. In 1999, all these markets experienced an extraordinary growth due to the high number of public offerings as well as the individual value of market capitalization. Particularly outstanding was the Neuer Markt, recording over 140 initial public offerings and accounting for more than 80 percent of all newly listed German companies, and capturing more than 60 percent of the funds raised on the stock market by German companies that went public (Consob, 2000: 33). Another market of rapid growth is the EASDAQ, an independent market like Nasdaq located in Brussels that unlike the former is not linked to the respective national markets.

The Spanish New Market (Nuevo Mercado) was not launched until April 2000 with ten listed companies and a capitalization of 40.2 million euros, becoming the third largest New Market in the euro zone (Banco de España,

1999). However, a comparison with the Nasdaq undermines its speedy start, indicating that European New Markets lag significantly behind the American one. The launching of New Markets in Italy and Spain has enhanced equity culture since these markets require higher transparency and accountability than regular markets.

Six, institutional investors have been, in comparison with other countries, largely absent from Italian and Spanish corporate governance, although they are starting to become relevant. Companies have historically not relied on stock capitalization, opting instead for debt financing or self-financing. This has a dual explanation. First, pension funds have not been necessary given strong welfare state provision in these countries. Second, huge public deficits have forced the state to continually borrow capital from the public, thus attracting a large part of household savings from private capital markets and into the government's coffers.

Discussion of these six issues in Italy and Spain indicates that these two national cases are best classified within the category of Continental or insider models of corporate governance, particularly because of their underdeveloped capital markets, and the concentration of ownership. However, a further issue needs to be explored: the role of banks.

The role of banks described in previous sections points to the principal dissimilarity between the Italian and Spanish corporate models. While in Spain there exist "mixed banks," in Italy in general there are no close and long-term relationships between banks and industry. Thus, while Spain's version of bank–industry relations falls into the bank-led or Continental model of corporate governance, Italy's pattern of bank–industry relations is one more typical of the Anglo-Saxon model. The banking patterns of these two countries will affect their respective corporate structures. One outgrowth of the role of banks is the degree of bank borrowing. Interestingly enough, despite the constraints on bank ownership, the debt/equity ratio of Italy is much higher than that of Spain, and indeed than those of other OECD countries except Japan.

In sum, Spanish and Italian corporate governance shares many key attributes, but they also differ in important respects. In particular, we can define the Spanish case as a typical Continental model, with financial and family ownership of industrial firms, high concentration of ownership, the leading role of banks, narrow stock markets, little separation between ownership and control, and the Spanish particularity of high foreign capital participation. Italian corporate governance exhibits many, but not all, of the latter features, therefore it must be defined as an outlier (Barca, 1996; Bianco et al., 1996; OECD, 1995). As in the Anglo-Saxon model, restrictive investment regulations and corporate culture have prevented Italian commercial banks from holding a substantial stake in nonfinancial companies. At the same time, other corporate governance devices more frequently found in the Anglo-Saxon or outsider model, such as acquisitions, fiduciary duties, and financial institutions, have not developed in Italy.

This chapter shows that historical legacies such as banking laws, protectionism, and the strong hand of the state have shaped and transformed corporate governance in these two countries in different directions despite equal pressures for international competitiveness and European harmonization.

Notes

1. The author would like to thank participants at workshops at the WZB, and the "Shareholder Value Capitalism and Globalization" conference, Bad Homburg, May 2001. Their comments received in these two conferences helped to improve the chapter.
2. Also referred to as: outsider, market-oriented, common law tradition, or "New American Model."
3. Also referred to as: insider, bank-oriented, French Civil Law tradition or "Rhine Model."
4. For studies on the Japanese corporate model see: Gerlach (1992); Hoshi (1998); Dore (2000); Ozawa (2000); and Jackson (2001).
5. According to Amatori (1997: 250), in 1991 the top 100 industrial companies by percentage of sales held, accounted for 40.1 percent of sales/current manufacturing in current prices in Italy.
6. According to the Istituto Nazionale di Statistica (ISTAT), in 1996, 94.8 percent of Italian firms had between 1 and 9 employees, 4.7 percent had 10–49 employees, ... and 0.01 percent had more than 1000 employees. Macey (1998: 701) suggests that "the industrial structure of the Italian economy doubtlessly can be explained by the fact that Italian firms with more than 15 employees are much more strictly regulated than firms with fewer than 15 employees."
7. This discussion of the Italian Corporate Law is based on Stranghellini (1995).
8. The recent corporate governance reforms are as follows: the establishment of the first Italian Competition Law in 1990 which instituted a Competition Authority, and the legal basis for privatizing state-owned companies with the Privatization Law of 1992. Moreover, in 1992 the major state entities (IRI, ENI, ENEL, INA, IMI, and BNL) were transformed into joint-stock corporations (SpA). Reforms in the financial markets refer to permission to banks to operate nationwide, more independence between the Bank of Italy and the Treasury, the 1991 Stock Market Banking Law, the 1992 law concerning takeover bids, the 1993 Banking Law, the opening of a primary market for private bonds in 1994, and the 1998 Draghi reform on financial markets, securities and corporate governance (OECD, 1994–95).
9. Stranghellini claims that "the high stability of the personally liable directors, who cannot be removed by a simple shareholders' vote, and the relative unlikeness of a financial breakdown of a company not involved in direct economic activity (either operating or financial), can render the form of societa in accomandita per azioni attractive for this use. For example, at the top of the Fiat group pyramid (a group with $20 billion turnover in 1994) is the Giovanni Agnelli & C. Società in Accomandità per Azioni" (1995: fn. 10).
10. This legislation reform was initiated by the so-called "Amato Law" in 1990 with the intention of accommodating the European Union Act – Uniform Code on

Banking and Credit of 27/9/93 (G.U. 30/9/93), which assimilates and puts into practice the contents of the EEC Council's Second Directive No. 89/646/CEE dated 15/12/89. The new 1993 Banking Law could have revolutionized the context in which the activity of banking is carried out in Italy (Filotto, 1995: 86), although business practices were already embedded in the corporate culture and are hard to change. See also Dermine (1990).

11. The only exceptions are the few banks that existed in Spain before the start of the Franco regime (1939). These are: Crédit Lyonnais, Société Générale, Banco Nazionale del Lavoro, Bank of London and South America (Salmon, 1995: 224–5).
12. The number of "big banks" has ranged from six (Hispano-Americano, Bilbao, Urquijo, Central, Vizcaya, and Espanol de Credito) in 1923 to five (Banco Central-Hispano, Banco de Bilbao y Vizcaya, Banco de Santander, Argentaria, Banco Popular) in 1997, to three in 2000 (Banco Santander Central-Hispano, BSCH; Banco de Bilbao Vizcaya Argentaria, BBVA, and Banco Popular).

3

Ukraine: the Newly Built State and Economic Institutions

Volodymyr Sidenko and Oksana Kuziakiv

Since gaining its state independence, Ukraine has engaged in a pro-democratic and pro-market transformation, like many societies of Central and Eastern Europe. What was different, however, from other countries considered in this book, was the necessary construction of the sustainable state/government institutions (*rozbudova derzhavy*) that paralleled the introduction of basic market principles. This combination of targets, in the context of a persistent legacy of the former Soviet Union's command economy, has determined the painful and inconsistent route of Ukrainian institutional transformation.

The aim of this chapter is to expose the Ukrainian mode of institutional change toward a market economy. Attention is mainly paid to the problem of an institutional framework for sustainable corporate governance. The authors' approach focuses on the analysis of the behavior of economic actors who have determined corporate governance in its actual shape, with clans formed around bureaucracy being at the core. Another goal is to show the role of privatization and the difficulty of the genuine growth of the private sector. Special regard is given to the way the banking sector influences corporate governance.

While the main focus of this chapter is concentrated on the micro level, the embedded political and economic environment in which governance practices have been constituted is also highlighted. The claim here is that political and economic ambience was a decisive factor for Ukraine in meeting the challenge of profound institutional transformation.

3.1 Ukrainian reforms in retrospect – the dominant tendencies

The departure point of Ukraine in its road toward a market economy, as with other Newly Independent States (NIS), was much lower than many other countries of the region that lie west of Ukraine.[1] This simple fact has brought huge consequences and has to be acknowledged in approaching the matter of Ukrainian performance.