The Reform of the Italian Corporate Governance

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Thank you for inviting me to the Italy Corporate Governance Conference and providing a most useful chance to analyse with you, and learn something more about the progress and deficiencies of our governance system.
Corporate Governance has been widely demonstrated to be linked to growth in a variety of ways. An efficient financial market is a key ingredient to direct investments towards the best opportunities. A country lacking an adequate Corporate governance system suffers heavily at least from two points of view.
On one side a bad governance system is exposed to the possibility of opportunism. We know that opportunism may arise in different ways depending on the intrinsic features of the economy, and actually arises in very different ways in the US and Europe. In the US the typical type of conflict arises from the separation between a normally diffuse ownership and an independent management. In Europe ownership, and especially control of the corporate system, is more concentrated and monitoring of managers is less of a problem. Exploitation of minorities however is more likely. In both cases a governance system that does not prevent opportunism is likely to deter savings and to prevent the flow of savings towards the best real uses. As the capital market integration progresses at the world level, an inadequate corporate governance means less competiveness vis a vis other countries and lower investment for the country.

On the other side profitable opportunities may arise not from the best use of capital, but rather from the exploitation of opportunities for other investors' money. This possibility distorts not only capital allocation but talent allocation, creating all sort of bad incentives. In the limit it may

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cause what some economists have called ‘economic entrenchment’, where privileged positions could be preserved by some investors also through lobbying.

In this sense an appropriate corporate governance system is a necessary condition to fully realize in Italy the application of article 47 of Our Constitution, where it requires that ‘the Republic promotes and protects savings ….and promotes the people’s access to … direct and indirect investment participation in the large firms shareholdings.’ Of course the *Padri Costituenti* were well aware that popular participation in shareholdings is subject to the risk of expropriation du to insufficient information (and insufficient ability to process information) for a single small shareholder. Therefore they explicitly mentioned the possibility of indirect participation. Strange as it may seem, the Italian Constitution explicitly recognizes the importance of popular participation to the property of capital, the necessity to protect this particular types of saving and the tantamount role of investment funds acting as agents of small investors.

As you all know, various Italian governments, including the one I represent, have devoted considerable efforts to improve our governance system, within the general framework of a global attempt to modernize the Italian economic system. Corporate governance has been in the past a big problem for Italy. Let me remind you that just 20 years ago a work by the Bank of Italy (Barca, 1995) characterized the Italian system in then following way:
‘*With control oriented financial institutions, takeovers and fiduciary duties lacking, separation between ownership and control is guaranteed by a mix of state ownership, pyramidal groups, and implicit rules, namely family and coalitions…The result is a limited degree of separation, a high stability of control ….that obstacles the mobility of control and obstacles growth.’*

To this I may add that, more importantly, the old regime certainly didn't encourage the access to the market for small and foreign investors.

More recently however a wave of regulatory and market initiatives have in my opinion changed this picture in a substantial way. Several academic and market-view studies have confirmed the continuous regulatory reform effort and the progress toward a corporate governance structure that matches some best practices.

I am particularly happy to remind some of the academic work in this area because, generally, Italy has never particularly benefited from a favorable or lenient approach in the assessment of policies from academic economists worldwide. This notwithstanding 7 years ago two of the most reputable worldwide economists expert in corporate governance, Enriques and Volpin, recognized that among other continental countries, I quote, 'Italy has enacted significant corporate laws reforms to strengthen the mechanism of internal governance, empower shareholders, enhance disclosure requirements, and toughen public enforcement.' (J. of Ec. Persp.). And more recently an academic work finds that earnings management, a practice that has long been linked to corporation malpractice or at the least to lack of transparency, is in 2012 not more important in Italy than the UK, the often cited best practice in corporate governance.

This evidence is by and large confirmed by last month's Assonime Survey on Corporate Governance in Italy and various Reports on the Compliance with the Italian Corporate Governance Code. Substantial improvement in all areas of interest are recorded. Enhanced substantial participation of minority shareholders to economic decisions has been ensured through more frequent meeting of the board and increased pre-board information. The composition of the Boards and the most important Control Commissions is on the whole satisfactory, ensuring in most cases a sufficient control on the Executives decisions. Improved transparency and incentives on remuneration is also welcome.

On this topic, if I could contribute to the debate, I would suggest that incentives be targeted against market benchmarks, to avoid in the future the possibility that a bubble inflates unreasonably executives remunerations and provides consequently perverse incentives to create the bubble. As somebody pointed out, we wouldn’t want to discover, when the tide goes out, that an executive who’s been paid nice bonuses even though underperforming the market, was actually also swimming naked.

The Code and the ‘comply or explain’ system seem to be working in ensuring the appropriate level of control. At the moment it does not appear also to have caused particular problems in terms of timely decision and effective exercise of power by executives.

Summing up, the Italian Corporate Governance system, as Gabriele Galateri just said, is in line with the best international practices.

However we should not grow complacent. First of all, progress in this area happens the whole world around, and we should be aware that we are competing for savings from all over the world, besides the Italian ones.

Secondly, real progress in this area does not follow immediately and automatically after appropriate legislation is enacted or after the application of a Code. Actual behavior and choices by individuals make the difference, and in the long run they change the perception about a certain governance system more than rules. Rules are prerequisites.

Finally rules’ enforcement has to become more strict and timely. We have a problem with time of enforcement in civil justice, the Government recognizes it and is dealing with it.

All this said, I welcome the fact that several features of the Italian system , like the *voto di lista* for example, are widely considered best practices and look forward to hear in this event suggestions for improving the system further. I am particularly keen to read the work on stewardship. I am convinced that only through an active approach the Funds’ manager will actually be fully realizing the mandate of the Constitution to have the people participating to the returns and also to the life of large corporations.

To conclude an adequate governance system is a key ingredient of the current recovery the Italian economy is finally experiencing and one further reason to believe that it is going to deliver a stable and robust growth.
Thank you for your attention and let’s get to work

Buon lavoro