

# Corporate Governance in Italy

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This paper has analysed the Italian prevailing corporate governance system in terms of issues such as ownership and control structures, structure and functioning of the boards, executive remuneration and evaluation, the mission of the companies, the role of banks and market for corporate control. The issues determined by the presence of the blockholder have been analysed as well as the changes that derive from the Draghi reform. The Italian system of corporate governance seems to be effectively summarised by the expression 'weak managers, strong blockholders and unprotected minority shareholders', paraphrasing Roe's (1994) sentence.

## Introduction

Today's developed economies are predominated by two main basic corporate governance systems: the relationship-based corporate system and the market-oriented corporate system (Franks, Mayer, 1992; Moerland, 1995). Regarding E.U. countries, the former may then be distinguished in two main sub-groups: the Latin and the Germanic systems (De Jong, 1997; Melis, 1999a). The Italian corporate governance system belongs to the Latin sub-group, although it has its own individual features, and does not fit completely into the international standard models.

The main purpose of this paper is to analyse the Italian corporate governance system. The characteristics of the ownership and control structure will be described, in order to offer a clear view of the Italian reality. Our attention is focused on the structure of the board and the following relationships: executive-non executive directors, directors-shareholders and majority-minority shareholders. The roles of the market for corporate control and the banks are analysed in order to underline the specificity of the Italian system. In contrast to the other European systems, neither the market nor the banks have a relevant influence on the Italian corporate governance system (Bianco, Casavola, 1996).

## Historical background

In Italy, the problems of corporate governance have usually been discussed concerning State-owned companies. However, in recent years, mainly due to the process of privatisation and EU integration, the issues related to corporate governance in public companies have increased their relevance among scholars and policy makers (e.g. Barca, 1995; Bianco, Casavola, 1996; Bianchi et al., 1997; Molteni, 1997).

The Italian company law has probably favoured excessively the certainty of control at the expenses of shareholders' protection (Bianchi et al., 1997). For this reason, many potential small investors have avoided to invest on the stock exchange in the past.

Empirical evidence shows that the great majority of Italian senior managers believes that the main objective for their companies is to maximise the value for the shareholders (Melis, 1999b). However, this fact should not be a source of misunderstanding. In fact, the expression "shareholders' value maximisation" does not represent the same concept in Italy as in the Anglo-American corporate model. In order to understand the exact meaning of 'shareholder' given by the Italian senior management, it has to be considered the average ownership structure, which is characterised by the relevant presence of blockholders. When senior managers claim

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that they run the company in order to maximise the value for the shareholders, they probably should say 'to maximise the value for the blockholder'<sup>1</sup>. This may happen at the expenses of the minority shareholders' interests.

For this reason, both CONSOB<sup>2</sup> (1995) and Bank of Italy (1996) have stressed the importance of a reform that would have reorganised the entire corporate governance system in Italy. The consequent debate has led to a new law for listed companies: the so called Draghi reform<sup>3</sup>, in force since July 1998.

The Draghi reform regulates financial markets and corporate governance in listed companies. The aim of the reform is to "strengthen investors' protection and minority shareholders", by regulating listed companies on issues such as shareholders' agreements, internal controls, minority shareholders' rights and public bids.

The Draghi reform differs from the previous codes on corporate governance (e.g. Cadbury, 1992; Vienot, 1995, etc.) for two main reasons:

- it is not merely a Code of practice, but is legally binding for all the listed companies;
- it does not cover any topics regarding the board of directors.

## Ownership and the market for corporate control

### *Ownership and control structure*

The ownership structure of the Italian non-financial listed companies is characterised by

a high level of concentration. CONSOB (1996) reports that the largest shareholder owns, on average, 48%. The identity of owners reveals that families, coalitions and other companies have a major role. Financial institutions holds a very limited amount of shares. The State plays an important role in some important companies, but is likely to lose its relevance due to the on-going process of privatisation.

The great majority of the companies' control structure is characterised by the dominance of a main shareholder (Bianchi et al., 1997), who acts as blockholder.

Blockholders tend to have a major control over management not only because of their high level of direct ownership, but also due to some devices, such as pyramidal groups, the issue of non-voting shares and shareholders' agreements. Cross-shareholdings are rarely important because of the limit imposed by the Italian company law.

Pyramidal groups have been defined as "a cascade of companies which can exert control through a complicated shareholding structure at a minimum cost" (Kendall, Sheridan, 1992: 68–69). In these groups, the holding company controls (directly or indirectly) the majority of voting rights of the companies which belong to the group and its ultimate control is either by a single entrepreneur, or a family or a coalition. This device is generally used to maximise the ratio between the amount of the resources controlled and the own capital invested to maintain the control. The structure of these groups is usually quite complex. Despite the rules of ownership disclosure, their exact control structure is difficult to trace, especially at an international level.

Table 1. Average ownership of listed companies by type of investor

Market capitalisation	Individuals	Foreign	State	Non Financial Companies	Banks	Insurance	Mutual Funds	Other financial	Total
5 percentile	9,00	17,02	0,00	38,98	6,36	0,07	0,44	1,35	73,22
10 percentile	19,14	15,19	0,00	23,81	11,14	3,52	0,44	0,00	74,58
25 percentile	6,00	11,15	0,00	46,68	12,18	0,47	0,47	2,16	79,11
50 percentile	5,22	9,44	0,60	43,90	8,06	1,13	1,46	1,94	72,41
75 percentile	3,39	10,55	5,87	38,17	8,04	2,88	0,85	0,42	69,26
90 percentile	2,74	4,05	0,70	34,31	10,22	5,61	0,53	0,19	58,35
95 percentile	0,00	1,77	1,38	26,74	17,68	1,05	0,20	0,62	49,44
>95 percentile	0,00	0,43	16,42	17,22	10,40	5,66	0,00	0,77	50,90
Total	5,01	9,29	2,62	38,08	9,57	2,37	0,76	1,09	68,50

Source: Consob (1996), in Bianchi et al. (1997), *Ownership, pyramidal groups and separation between ownership and control in Italy*, Appendix, table 32.

Table 2. Average ownership concentration of listed companies

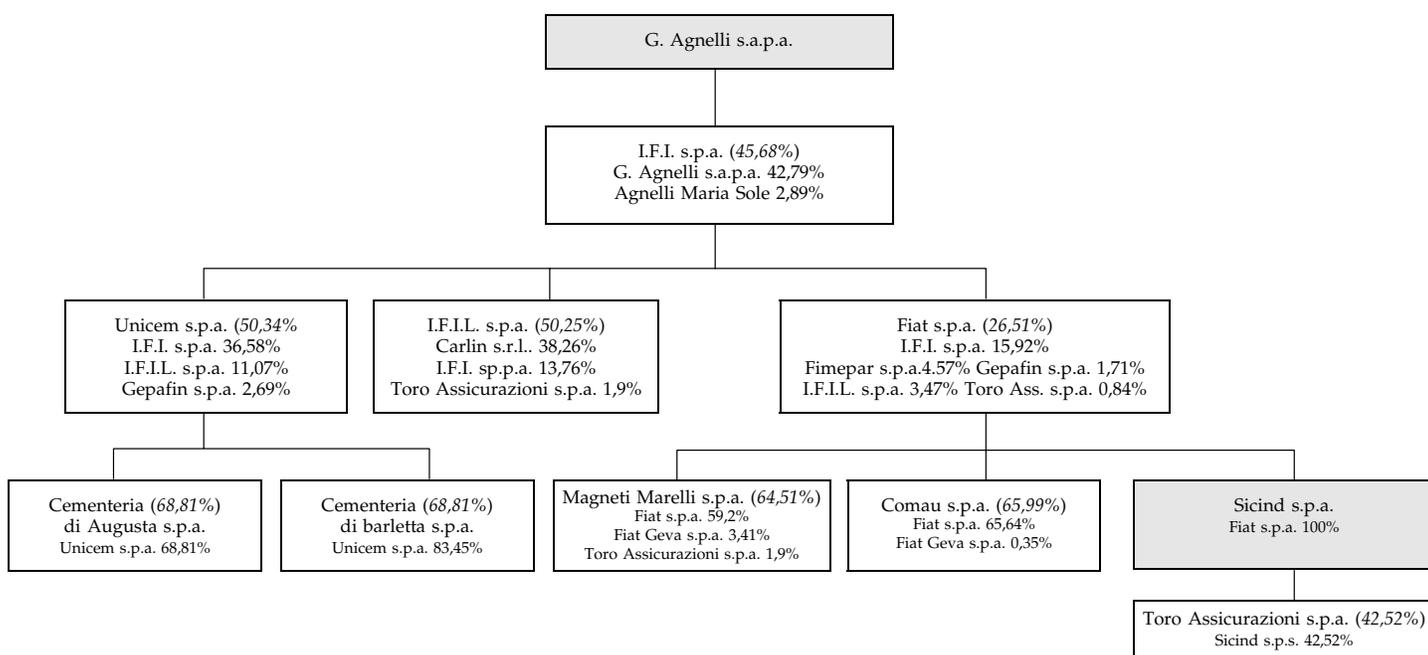
Market capitalisation	Largest stake	2nd	3rd	4–10th
5 percentile	50,53	14,18	4,19	4,20
10 percentile	46,33	10,31	6,59	9,29
25 percentile	53,27	8,90	4,92	10,87
50 percentile	47,57	11,98	5,09	6,54
75 percentile	50,09	10,1	3,52	6,12
90 percentile	42,42	9,36	2,95	3,54
95 percentile	37,02	7,00	3,17	2,23
> 95 percentile	48,63	2,55	2,03	2,31
Total	48,02	10,14	4,12	6,13

Source: Consob (1996), in Bianchi et al (1997), *Ownership, pyramidal groups and separation between ownership and control in Italy*, Appendix, table 22.

The issue of non voting shares is largely diffused among the Italian companies (Barca, 1993), with the only limitation in the total par value no higher than the total par value of

voting shares. With this mechanism, the senior management has an alternative source for corporate funding, which is risk-free for the control of the company, since it has no voting right.

A simplified company structure of Fiat group



Source: Centrale del Bilanci s.r.l. – 30th June 1997

☐ Listed company

Values in italics represent the share owned by companies which belong to the group

The whole structure of the group is composed by 1018 companies

G. Agnelli s.p.a. is a partnership

Figure 1.

Shareholders' agreements are a fundamental device especially at the highest level of the control chains. The Draghi reform has modified their regulation, in order to weaken their power as mechanism to maintain the control of the company by a coalition of blockholders. The length of the agreement between the shareholders cannot be longer than three years, after which it has to be re-negotiated. The partners are now given the right to withdraw from the agreement in case of public bids. This right may weaken this mechanism since it seems to foster the possibility of takeovers, at least in theory. In fact, it is not predictable how it will work since not only shareholders' agreements has always been contracts but also implicit contracts, i.e. a sort of gentlemen agreements among some of the most important Italian coalitions.

By the previous devices, it is possible to create a separation between ownership and control, so that blockholders may control huge amounts of capital by owning a relatively small share. CONSOB (1996) reports an average separation (capital under control/capital owned) of 2.8. The data are probably underestimated because of the difficulty to identify the ultimate controlling agents when the control chain ends with a company (Bianchi et al., 1997).

### *Market orientation and the role of the market of corporate control*

The capital market orientation of the companies and the role of the market for corporate control are key features to understand the institutional framework of a corporate governance system. The Italian system is characterised by a limited role of the stock market. However, if the role assumed by the stock market may appear as an anomaly to Anglo-American eyes, in this respect the Italian case is not too different from other continental European countries, such as Germany and, especially, France (Pagano et al., 1998).

The stock exchange does not play a highly relevant role, even in listed companies. Self-financing and bank debts are the main sources for corporate funding. The issue of new shares, with or without shareholders' stock option, has a minor relevance (Melis, 1999b). This choice of corporate funding leads to a financial structure which is characterised by one of the lowest level of equity compared to debts and assets among the OECD large economies (Guatri, Vicari, 1994). This financial structure seems to be effective in order to allow senior management to help the blockholder to keep the control of the company since potentially dangerous (for the blockholder)

*Table 3. Listed companies by country and their total market value*

Country	Market capitalisation* in ECU mn	N. of Listed Companies**		
		Domestic	Foreign	Total
France	813.323	782	179	961
Germany	996.830	739	2766	3505
Italy	465.100	239	4	243
U.K.	1.886.765	2407	521	2928

Source: \* Federation Internationale Des Bourses De Valeurs (FIBV); \*\* Federation of European Stock Exchanges (FESE), November 1998.

*Table 4. Degree of separation of ownership and control among non-financial groups*

1. Giovanni Agnelli & C. S.a.p.a	8.86	7. Ligresti Salvatore	4.83
2. Compart S.p.a. (1)	4.35	8. Berlusconi Silvio	3.66
3. Benetton	1.46	9. Bulgari S.p.a. (1)	1.80
4. Pirelli	1.95	10. De Benedetti Carlo	10.33
5. Radici Pesenti Rosalia	4.15	11. Pininfarina Sergio	5.93
6. Tanzi Calisto	1.68	12. Bosatelli Domenico	1.39

Source: Consob (1996). (1) The head of the Group is the coalition controlling the company.

investors are not allowed to have a relevant stake in the company. Empirical evidence seems to confirm this strategy. Despite the fact that the main factor that influences the choice of corporate funding is its cost, it has to be stressed the importance of 'political' reasons as well (Melis, 1999b). It is not rare that the senior management prefers a certain source of corporate finance in order to prevent any potential threat against the control of the company.

The market for corporate control does not have an important relevance and hostile takeovers are rare<sup>4</sup>. When mergers and acquisitions occur, they are basically friendly and through either the mediation of a main merchant bank (e.g. Mediobanca) or a private agreement between coalitions or families. The sales of a majority stake are normally arranged at prices implying a very large premium on stock market prices (Caprio, Floreani, 1996). Zingales (1994) reports an average premium of 82% associated with the voting rights of shares on the Milan stock market. This large premium may be interpreted as an evidence of significant private benefits of control that arise at the expense of the minority shareholders (Shleifer, Vishny, 1997).

The Draghi reform has modified the regulation of public bids. For example, the bidder will have to offer a public bid for the total amount of shares if owns more than 30% of the shares. The aim of this regulation is to give the minority shareholders of a target company the opportunity to gain the same economic advantage as the majority shareholder. However, this change on the mandatory public bid might be ineffective, because it could reduce the possibilities of takeover either making it too expensive for the public bidder or encouraging to exclude potential target companies from the listing on the stock exchange.

### **The role of the banks and the other financial institutions**

Banks usually play a minor part in corporate governance in Italy. Although they have a relevant stake in corporate external financing, feeble bank-firm relations jeopardise the role of the banks (Ferri, Pesaresi, 1996). Despite the similar framework of 'universal bank', the Italian system is not characterised by a main bank relationship as the German system. The practice of multiple loans is widespread. This multilateral relationship may be considered to be efficient in order to spread the risk, but also reduces the incentives for the banks to

have a stake and monitor corporate management, since it never happens that a bank has a large share in a single firm. Even when, and it is not rare, banks provide long-term capital to companies, they are neither involved in the corporate strategies' formulation and implementation, nor considered as a partner for corporate strategies by the management, and rarely have their representatives in the board of the companies.

Being involved in the management of the companies is not considered to be the objective of the banks (De Polis, 1997). For this reason, banks do usually not influence management strategies, as far as companies are able to refund their debts. This is the main objective of most of the Italian banks. However, a bank may influence the management indirectly, by recalling its credits.

An important exception to this behaviour is Mediobanca. This bank, linked through a web of inter-corporate shareholdings to some of main Italian families, has had a relevant corporate governance role guaranteeing the stability and growth of the largest private groups and has often acted to pursue major corporate rescue plans (De Cecco, Ferri, 1996).

The other financial institutions usually play a marginal role (Bianchi et al, 1997); however, things are changing rapidly and they are developing and are also starting to have an active role in some shareholders meetings. A good example has recently been given by foreign institutional investors, during the successful fight to remove the management of Olivetti Spa.

### **Weak managers, strong blockholders and unprotected minority shareholders**

Italian mainstream literature (e.g. Saraceno, 1964; Coda, 1967; Onida, 1968; Zanda, 1974) analyses the issue of the separation between ownership and control mostly according to a non-sectional managerial perspective, arguing that managers pursue the interests of shareholders, i.e. the separation between manager and shareholder does not produce relevant agency costs. The prevailing ownership and control structure reduces the potential agency problems between senior management and shareholders, because the blockholder is an active investor, able to reduce the information asymmetry and has the incentive to monitor effectively and influence the senior management according to its interests.

Stonehill and Dullum (1990) note that the ownership structure in Europe leads to a

choice of corporate objectives consistent with the corporate maximisation model. However, the survival of the firm with a fair remuneration for the shareholders is chosen as main objective only by a small minority of Italian senior managers (Melis, 1999b). This fact seems to confirm the weakness of the managers in relation to the strength of the blockholders, since this goal may be considered as an optimal managerial objective (it may maximise managerial interests), while it does not maximise shareholders' interest.

However, the agency problem is not totally eliminated, but simply shifted towards the relationship between different types of shareholders.

Conflicts of interests arise both between shareholders with full voting rights and shareholders with no voting rights, who are interested in the guaranteed dividend, as well as between blockholders and minority shareholders with no possibility of monitoring the management. Because of the reality of the market for corporate control, minority shareholders cannot even count on outside managerial discipline mechanisms, consequently they often found themselves in the difficult situation of impossibility of having their interests effectively safeguarded. Minority shareholders often cannot have any significant role in corporate governance, they are not guaranteed enough by the intervention of courts, because the device of fiduciary duties is largely unavailable and derivative suits are ineffective (Giudici, Paleari, 1998).

The Draghi reform fosters the rights of the minority shareholders: shareholders representing at least 10% (or the lower percentage established by the by-laws) of the equity issued may convene the shareholder meeting. Moreover, shareholders, entered in the register of shareholders for at least six months, representing at least 5% of issued equity may bring a company action for liability against the directors, the members of the board of statutory auditors or general managers, even if the company is in liquidation. Company's by-laws may lower the threshold.

Corporate governance is still seen by the senior management as a private issue (Molteni, 1997). There is little evidence of the presence of any corporate governance committee and only few companies (e.g. Fiat) have a plan to set it up in the close future. Most of the companies have no intention to set up a committee within five years (Melis, 1999b). This evidence seems to confirm the argument of Molteni (1997), who notes that senior management believes that there are already too many laws and regulations to be willing to set up new rules for the structure of

the board and the corporate governance of the company.

## The structure of the boards

The Italian listed companies are characterised by a particular board structure composed by a board of directors (Consiglio di Amministrazione) and a board of statutory auditors (Collegio sindacale), both appointed by the shareholders' meeting.

The Draghi reform has not made any changes on the structure of the board of directors. Relating to composition of board of directors, non-executive directors (NEDs) generally represent the majority of the board. Directors, both executive and non executive, are proposed by the chairperson or by the blockholder and appointed by the shareholders' meeting, which is under the control of the blockholder. The duration of their appointment is usually predetermined and lasts three years.

NEDs usually have the duty to control of the executive directors and support them in the formulation and implementation of the corporate strategies. NEDs are sometimes involved in the decision of the C.E.O. remuneration. Empirical evidence shows that the research and selection of the executive directors is not a task which NEDs are involved in (Melis, 1999b). Executive directors are usually researched and selected by the blockholder.

Interlocking directorship is a common reality among listed companies, especially within the same pyramidal group, and acts either as a substitute or as an integration of the ownership links in order to let the blockholder maintain the control of the group.

The separation between Chairperson and C.E.O. usually characterises the structure of the board. This separation tends to be considered as crucial to allow the board independence (Cadbury, 1992). Despite the respect of this condition, the Italian senior management can hardly be considered as independent for two main reasons:

- the division of roles between the Chairperson and the C.E.O. is not clear enough;
- the great influence that the blockholder has on the management. The board of directors often simply ratifies the decisions taken by the blockholder (Brunetti, 1997).

NEDs often find difficult to verify the information given by the executive directors. They do have the access to the sources of information, however the act of verifying the information tends to be perceived like against

the implicit rules within the board (Molteni, 1997).

The board of directors is rarely characterised by the presence of organs such as audit committee, remuneration committee and nomination committee. Sometimes there is the presence of an executive committee which absorbs most of the key functions of the board of the directors, giving the rest of the board the duty to ratify what is decided in the executive committee (Molteni, 1997). The presence of an executive committee with such a degree of power may offer a basis on which to develop a two-tier board structure.

The Draghi reform has modified the role and the functioning of the board of statutory auditors. This board is to be composed by at least three members, with minimum one (at least two, if the board is composed by more than three members) representative of the minority shareholders. At least two members of the board have the power to call the shareholders' meeting when they believe it necessary because of a senior management's decision. Before the Draghi reform, its main duty was to monitor the board of directors to safeguard the corporate property (concerning accounting issues), but it had no voice in the strategic decisions. The Draghi reform has solved the previous problem of potential overlapping of the role of the board of statutory auditors with the external auditor, since the monitoring of the accounting issues is given to the external auditor. The board of statutory auditors is now given the duty to supervise the executive directors, with a duty similar to the NEDs. However, now the potential risk of overlapping is between the board of statutory auditors and the NEDs. In fact, the board of statutory auditors has partially remained 'non-political' (i.e. not involved in strategic issues), but has also become closer to the German supervisory board. In this perspective it may be interpreted the presence of the minority shareholders' representatives in the board. The Italian corporate governance system seems to have changed its characteristics, becoming something a sort of 'half-way house' between a unitary board system and a two-tier board system.

## Executive remuneration and evaluation

The executive evaluation is mostly conducted by the board of directors with a non-structured procedure. The control structure allows the flow of information and does not always need a structured and constant method to

effectively evaluate the executive directors. The evaluation is based on criteria such as the degree of achievement of the objectives stated in the year plan and a comparison with the industry results, rather than the share value on the stock market.

The executive remuneration is usually either decided by the shareholders' meeting or the management board. However, cases where both the board of directors and the shareholders' meeting have a joint decision making process are not exceptional (Melis, 1999b). The remuneration committee is not a common tool.

Due to the lack of disclosure about executive remuneration (before Consob regulation in 1998, annual accounts have usually reported only the total compensation paid to the executive directors altogether), there is a lack of information about this issue.

Empirical evidence reports that the executive compensation is characterised by the limited use of long-term incentives (Brunello et al., 1997). The fixed amount represents most of the remuneration, which may be integrated either with bonus (more often) or with stock option (rarely). The use of pension funds is exceptional, at least among non financial companies, because of a 'generous' State pension system (Melis, 1999b).

The role of stock options seems limited by the inefficiency of the Italian stock exchange market, with the consequent poor reliability of stock returns as a measure of managerial performance. However, it seems that the relevance of share plans may increase in the next years. A 1998 survey by Studio Ambrosetti shows that 49% of the listed companies have stock option plans for the next years.

Sometimes, executive remuneration is strictly linked to corporate profits. In fact, a small amount of executive directors of non financial listed companies receive a percentage of corporate profit as compensation (Melis, 1999b). Linking executive remuneration to corporate profit may seem to be dangerous for the shareholders, since executive directors might manipulate profit in order to pursue their own interests. However, it must be taken into consideration the fact that all the companies that use this mechanism are characterised by the presence of a blockholder, who monitors effectively the senior management in the calculation of the corporate profit.

## Final remarks

This paper has analysed the key features of the corporate governance in Italy. The Italian

system is characterised by a poor capital market orientation and a virtually non-existent market for corporate control. Although banks have a relevant stake in corporate external financing, they play a minor part in corporate governance. The ownership and control structure is characterised by the presence of a blockholder, an active investor, able to monitor the senior management effectively. Due to this structure, minority shareholders are likely to be the victims of the blockholder.

While in the Anglo-American corporate governance systems there is a great concern about the potential abuse of executive power, in Italy the concern should be on the potential abuse of power from the blockholder. If "strong managers, weak owners" (Roe, 1994) summarises the issues of corporate governance in the USA, the expression 'weak managers, strong blockholders and unprotected minority shareholders' may effectively summarise the Italian reality. Undoubtedly, the minority shareholders' rights are fostered by the Draghi reform, however the question is to which extent the law will let minority shareholders have a real stake and be effectively active in corporate governance, weakening the power of the blockholders.

Further research should also analyse how the possible developments of board structure, taking into consideration the evolution of the board of statutory auditors and the presence of the executive committee as potential pressures towards a two-tier board structure.

## Notes

1. A good example of this behaviour is given by the Comit Spa case. Regarding this case, Zingales (1999) notes that the previous management has been dismissed because it preferred the offer from Unicredito Spa to the one of Banca Intesa Spa. The new senior management has accepted the second offer. However, regarding shareholders' value maximisation, the Banca Intesa's tender bid is not any better to UniCredito's hostile bid, however it may better pursue the strategic interest of control of the blockholder.
2. The body that specifically controls the securities markets, which is, to some extent, modelled on the SEC of the USA.
3. Law: Decreto Legislativo 24 febbraio 1998, n. 58.
4. The hostile takeover of Telecom Italia Spa. by Olivetti group may be considered as exceptional, due to the particular (according to the Italian standards) ownership structure of the target company.

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#### Book Note

##### **Changing Paradigms – the transformation of management knowledge for the 21st. century; Thomas Clarke and Stewart Clegg; HarperCollins, London, 1998**

Tom Clarke (a member of the Editorial Advisory Board of this journal) and Stewart Clegg have produced a monumental work. Management paradigms, the sets of ideas through which we view the managerial world, are being transformed the authors believe. Many of today's management practices build on traditional notions: not all are relevant to the future. Changing technology, markets, products and processes call for new paradigms that allow for greater intelligence and creativity, the capacity to ask discerning questions and to learn. The themes chosen to group the perceived paradigm shifts are: globalization, digitalisation, strategy, organization, stakeholders and sustainability. Corporate governance features under 'stakeholders'. The contrasting paradigms of agency, stewardship and stakeholder theories are rehearsed; the differences in paradigms that produce different governance practices and board structures are discussed. The authors conclude that, although to some business people the stakeholder concept remains largely a public relations exercise, "a stakeholder approach may be not just a moral imperative but a commercial necessity in a world where competitive advantage stems more and more from the intangible values embodied in human and social capital. It is becoming more difficult for companies driven by a narrow self-interest to survive public scrutiny: it is still possible to make money in the short-term but companies that are durable invariably possess a wider and deeper sense of their responsibilities.