Corporate Governance Changes in the 20th Century: A View from Italy

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Abstract

In this paper, I consider four stages of Italian development in the 20th Century: liberalism, the mixed economy, the welfare state and the new economic constitution. In the first stage, liberalisation favoured economic and financial development. However, an important feature of Italian governance was the role played by the State. Initially this role was limited to supporting industrial growth; in the second stage of economic development, it involved the acquisition of banks and industrial companies by the State. Public ownership of large sectors of the economy and the equity markets' limited role in the financing of industry made company law modernisation less important from a policy perspective. In addition, the incumbent capitalists benefited from the State's occupation of large sectors of the economy. As a result, the rules on joint-stock companies, which were included in the Civil Code of 1942, were very mild in protecting minorities and largely ignored the joint-stock companies' role in the capital markets. More than thirty years elapsed before the introduction, in the third stage of Italian development, of disclosure rules for listed companies and of a securities regulator. Corporate governance reform was delayed until the end of the '90s, while a general reform of company law was enacted in 2003 reflecting a new stage of financial development started in the 90s as a consequence of trade liberalisation both in the EC and worldwide. However, astounding financial scandals showed that even the recent reforms are based on shaky foundations, to the extent that both public and private enforcement are weak, particularly with respect to listed companies. On balance, the Italian experience, despite offering examples of convergence towards global standards, does not support the 'strong convergence' theory and is better explained by the rival scholarly position which sees political forces and path dependency as shaping and constraining economic evolution.

Keywords: corporate governance, Italy's corporate governance
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1 INTRODUCTION

This paper comments on Harald Baum, *Change of Governance in Historic Perspective: The German Experience*[1], by briefly analysing the Italian experience in the same period of time. Whilst the individual developments as to corporate governance and regulation are no doubt different in Germany and Italy, reflecting as they do profound differences in the economic, legal and political settings, a broad view of the 20th century's evolution shows substantial similarities. First of all, at least three stages of development can be identified, as argued by Professor Baum: liberalism, the welfare state and the welfare state's crisis. However, in this paper, I consider four stages of Italian development following a similar classification proposed by an Italian scholar[2]: liberalism, the mixed economy (characterized by the mounting role of the state in the economy), the welfare state (the origins of which, however, date back to the beginning of the century) and the new economic constitution. Each stage will be analysed by one of the following sections. The fourth stage basically coincides with that defined by Professor Baum as the crisis of the welfare state and includes changes in governance and regulation broadly converging with those found in other European States. Many of these changes were determined by the European Union either directly (through legal harmonisation) or indirectly. European developments, in turn, are often a reflection of global changes making pressure towards convergence.

Nonetheless, convergence is not sufficient to characterize the German and Italian experiences in the last two decades of the 20th century. As shown by Baum's paper, also path dependency played a role in German legal reform. Similar comments can be made for Italy, as the present paper will conclude. On balance, the German and Italian experiences, despite offering good examples of convergence towards global standards, do not support the "strong convergence" theory

[1] ECGI, Working Paper Series in Law, No 28.

[2] Sabino Cassese, *La nuova costituzione economica* (Roma-Bari, 2001), p. 7 ff.

advanced by some law and economics scholars[3]. These experiences are better explained by the rival scholarly position which sees political forces and path dependency as shaping and constraining economic evolution[4]. As I argue below, the political theories of corporate governance and financial development significantly contribute to the analysis of the Italian experience.

2 LIBERALISM AND THE COMMERCIAL CODES

In this section, I consider the formation of two consecutive Commercial Codes after Italy's unification in the age of liberalism. This age extends for about forty years in the second half of the 19th century and is characterised by the very limited role of the State in the economy. The State intervened mainly in the field of public infrastructures, while economic activities were private and subject to self-regulation by the newly instituted chambers of commerce[5]. Industrialisation was limited to some areas of the country, which was mainly rural. The liberal State was confronted with industrialisation only at the turn of the century, when the Italian economy joined the second industrial revolution led by the U.S. and Germany. Early industrialisation was accompanied by the creation of a number of public undertakings mainly in the area of public services, insurance and banking[6]. Railways, which were privately operated under public franchises, were nationalised in 1905 and became part of the Government administration.

[3] The strong convergence thesis is best exemplified by Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law* (Harvard 1991), p. 212 ff. and, more recently, by Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 Geo. L. J. 439. See John Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications' (1999) 93 NW. U. L. Rev. 641, at 646 ff., for an enlightening overview of the main strands of thought in this area.

[4] See Lucien Bebchuk and Mark Roe, 'A theory of Path Dependence in Corporate Governance and Ownership' (2000) 52 Stanf. L. Rev. 127. John Coffee, note 3, 650 agrees that formal convergence faces too many obstacles to be predicted; he argues, however, that functional convergence can occur through the international securities markets.

[5] See Sabino Cassese, note 2, p. 8 et seq.

[6] *Ibidem,* p. 12 et seq.

2.1 The Commercial Codes' Rules on Companies

One of the main themes of discussion as to company law reform in the new Italian Kingdom was whether limited liability companies should be subject to governmental authorisation, as provided by the pre-unification commercial codes[7] along the French model[8]. In a report written by Tommaso Corsi, a member of the House of Representatives who worked on a company law reform project in 1862, a proposal was made to abolish the authorisation regime as incapable of preventing frauds and excessively limiting freedom of trade[9]. In lieu of the companies' public surveillance, it was recommended to regulate better the relationships between shareholders and directors, as well as those amongst shareholders. However, this proposal was fiercely opposed in the wake of financial fraud cases and was later rejected by Parliament when adopting the first Italian Commercial Code in 1865. This Code largely followed the *Codice Albertino* model[10] and reinforced the public

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[7] Despite the elaboration of numerous draft commercial codes in the States into which Italy was divided before its unification, Napoleon made the *Code de commerce* applicable to the Italian Regions annexed to the French Empire (including Liguria, Piedmont and Tuscany), to the *Regno Italico* (of which Milan was the capital) and to the Kingdom of Naples. See Antonio Padoa Schioppa, *Saggi di storia del diritto commerciale* (Milan, 1992), p. 137 et seq. After the Restoration, the *Code de commerce* was kept in force in several regions, such as the Lombard-Venetian Kingdom, the Grand-dukedom of Tuscany and Genoa, while other States (such as Piedmont and the Pontifical State) adopted their own commercial codes, which, however, followed closely the French model (*ibidem,* p. 141 ff.). The Kingdom of Sardinia proceeded to a new codification of all its laws in the thirties, which led to the adoption of a new commercial Code in 1842, still modelled on the French Code but with some differences.

[8] The *Code de commerce* which was adopted by Napoleon in 1807 included a few Articles on the limited liability company (*société anonyme*). This company ceased to be subject to the special privilege of incorporation and was regulated in a general, though concise, way by the law. See Georges Ripert, *Aspects juridiques du capitalism moderne* (2nd ed., Paris, 1951), p. 51. However, the introduction of a general incorporation regime did not mean freedom to set up limited liability companies. Less liberal than the New York Law of 1811, which also abolished the special charter privileges, the *Code de commerce* introduced an administrative authorisation regime as to the formation of the *société anonyme* (Art. 37). This regime was officially justified with reference to private law arguments, such as the protection of subscribers and third parties from speculation and frauds; however, it also reflected more fundamental public policy concerns, as the centralism of the Empire did not tolerate independent social powers. See Paolo Ungari, *Profilo storico del diritto delle diritto delle anonime in Italia* (Rome, 1974), p. 30 et seq.

[9] See Antonio Marghieri, *I motivi del nuovo Codice di Commercio italiano* (Naples, 1885-1886), Appendix, p. 193 et seq.

[10] See note 7.

surveillance regime by instituting a new Control Office (*Ufficio di sindacato*) both to authorise new companies and to monitor existing ones[11].

It was only with the second Commercial Code, adopted in 1882, that a more liberal attitude was taken and governmental authorisation was abolished, as had already been done in France in 1867. Consequently, the conditions as to company formation were specified by the Code, and the Civil Tribunal was empowered to ascertain these conditions before the company's registration.

The Code was the result of drafting efforts which extended over more than a decade with the participation of some of Italy's finest scholars[12]. This was reflected by the high technical quality of the Code which was in line with its homologues in Europe, such as the English Law of 1861, the French Law of 1867, the German Commercial Code of 1861 (*ADHG*) and the Law of 1870, and the Belgian Law of 1873, all widely considered throughout the legislative work[13]. The convergence of national company law rules reflected the internalization of the economy in the 19th century. As argued by Professor H. James, at the end of that century international integration was similar, if not more advanced than that found in the last part of the 20th century[14]. The Italian Code included, for those times, advanced regulation of limited liability companies (*società anonime*). Amongst the novelties was the introduction of a board of auditors to monitor the company's management and accounts on behalf of shareholders and creditors, along the model of English Law, and, as a counterbalance, the abolition of the administrative surveillance regime[15]. On the whole, the Code

[11] See Antonio Padoa Schioppa, note 7, p. 213 et seq.

[12] *Ibidem*, p. 157 et seq.

[13] *Ibidem*, p. 226.

[14] See Harold James, *The End of Globalisation.* Lessons from the Great Depression (Cambridge, Mass., 2000), arguing: "At the end of the nineteenth century, the world was highly integrated economically, through mobility of capital, information, goods, and people. Capital moved freely between states and continents" (p. 10). The author provides some measures of integration with reference to the size of net capital movements and the levels of trade: "For most countries, despite all the intervening improvements in the means of transportation, the levels of trade of the prewar world were not reached again until the 1980s" (p. 12).

[15] See Paolo Emilio Bensa, 'I sindaci della società per azioni, cenni storici e comparativi' (1883) Rassegna di diritto commerciale 1.

followed "the first systematic approach to companies. The general meeting and its functioning, the directors and their responsibility, corporate control and the protection of minorities, the regulation of accounts, liquidation and mergers found in these texts [i.e. the Code and its previous drafts] a modern treatment"[16].

2.2 Industrialisation and Financial Development

All this helps to understand why the Commercial Code and its rules on companies, in particular, remained in force, with minor modifications, for sixty years. However, the economic development that occurred throughout this period of time exerted considerable strain on the Code's regulation of limited companies. New problems were created with which the Commercial Code was ill-equipped to cope: the formation of company groups, cross-shareholdings, voting limitations and multiple voting shares, controlling minorities and the separation of ownership and control [17]. In fact, at the time of the Code's adoption, Italy was still a rural country, despite some notable examples of industrialisation, particularly in the Northern regions and in the fields of mechanical and textile industries. But in the first decade of the 20th century, Italy joined the small group of industrialised nations: "To be true, the industrial takeoff was completed only at the end of the first world war; in addition, a significant part of the country was cut off from economic development. Nonetheless, from the beginning of the century the industrial structure of our country was consolidated and a modern society started to emerge, characterised by substantial urbanisation and fast growth of national income"[18]. This was also a reflection of the second industrial revolution

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[16] See Gastone Cottino and Gustavo Minervini, 'La società per azioni a cento anni dal codice di commercio', in *1882-1982 Cento anni dal Codice di Commercio* (Milan, 1984), p. 112. On the role of the 1882 Code in Italian legal history, see Stefano Rodota', 'Le libertà e i diritti' in R. Romanelli (ed), *Storia dello Stato Italiano dall'Unità a oggi* (Rome: Donzelli Editore, 1995) 317.

[17] See Giuseppe Ferri, 'La disciplina delle società nel Codice di commercio del 1882', in *1882-1982 Cento anni dal Codice di Commercio,* note 16, p. 105. For an economic analysis of the relevant governance structures, see Franco Amatori, 'La grande impresa', in *Storia d'Italia, Annali,* 15, *L'industria* (Turin, 1999), p. 691 et seq.

[18] See Valerio Castronovo, *L'industria italiana dall'ottocento a oggi* (Milan, 1990), p. 71.

occurring in other countries, particularly the United States and Germany[19]. New companies were formed in Italy to produce electricity, steel, automobiles, tyres, trains, typewriters, etc., with the financing on the part of a few large banks and the support of the State[20].

The beginning of the 20th century was generally characterized in Europe by "very high levels of financial development, higher than what we have seen as recently as 1980"[21]. Rajan and Zingales consider three different indicators of financial development in 1913 and 1980 for a number of developed countries (including Italy). Firstly, the ratio of deposits to GDP dropped by 20 percent between 1913 and 1980 suggesting that banks played a relatively bigger role in intermediating funds at the beginning of the century[22]. Secondly, the ratio of stock market capitalisation to GDP dropped by more than 50 percent indicating that equity markets were more developed at the beginning of the century[23]. Thirdly, the fraction of investments financed through equity issues dropped from 13 percent to 2 percent over the period suggesting that equity issues were a more important source of investment funding in 1913 than in 1980[24]. There was, however, diversity amongst the countries considered: for instance, "the equity market in 1913 was much more important in England, Belgium and France than in the United States"[25]. Moreover, Italy's level of

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[19] See Alfred D. Chandler, Franco Amatori and Takashi Hikino (Eds.), *Big Business and the Wealth of Nations* (Cambridge, 1997), for a comparative analysis of several countries' industrial development in the period in question.

[20] See Nicola Crepax, *Storia dell'industria in Italia: uomini, imprese e prodotti* (Bologna, 2002), p. 37 et seq., noting that this was the American century, the age of "Fordism", mass production and standardisation of products (p. 40).

[21] Raghuram Rajan and Luigi Zingales, *Saving Capitalism from the Capitalists* (London, 2003), p. 191. For a more detailed analysys, see Raghuram Rajan and Luigi Zingales, 'The Great Reversals: The Politics of Financial Development in the 20th Century' (2003) 69 J. Fin. Econ. 5. For an explanation of the 'great reversal' phenomenon, see E. Perotti and E. von Thadden, 'The Political Economy of Dominant Investors', working paper, June 2004, arguing that some financially developed countries moved towards bank or state control as a financially weakened middle class became concerned about income risk.

[22] *Ibidem,* p. 192.

[23] *Ibidem,* p. 193.

[24] *Ibidem,* p. 194.

[25] *Ibidem.*

financial development was relatively low in 1913, particularly with reference to the second and third indicators (even though also for Italy both indicators dropped from 1913 to 1980).

Putting the Italian scenario in perspective, between 1900 and 1907 the number of companies listed at the Milan Bourse increased from 59 to 169, with the bulk of new listings concentrated in the last three years, a record figure in the whole century[26]. The stock exchanges' capitalisation amounted in 1907 to 70 per cent of Italian equity[27]. Nonetheless, stock exchange trading was dominated by speculation, which was financed by the large banks, concurrently operating as providers of equity and loans to industry[28]. In 1907, the stock markets started declining, as a result of an international liquidity crisis which caused a credit restriction, and continued to do so until 1920, with a drop of 80 per cent in capitalisation in real terms. This crisis caused significant problems to the banking system and is considered as a landmark in the history of Italian capital markets, which subsequently ceased to develop in relative terms and remained thin and inadequate to finance economic development[29]. In the meantime, public ownership started to grow as an alternative mode of enterprise financing: railways, which were previously run by private companies, some of which listed, were nationalised in 1905; new banks were created as public entities to finance either public works or specific sectors of the industry; a public insurance undertaking was formed to offer life insurance as a monopolist[30].

3 THE "MIXED ECONOMY" AND THE CIVIL CODE

The period defined as "mixed economy" covers approximately thirty years extending from Fascism to the new Republican Constitution (1948). It is characterized by State dirigisme and an

[26] See Giovanni Siciliano, *Cento anni di borsa in Italia* (Bologna, 2001), p. 17 et seq.

[27] *Ibidem.*

[28] *Ibidem.*

[29] *Ibidem*, quoting Anna Maria Biscaini Cotula and Piero Ciocca, 'Le strutture finanziarie: aspetti quantitativi di lungo periodo (1870-1970), in Fausto Vicarelli (ed.), *Capitale industriale e capitale finanziario: il caso italiano* (Bologna, 1979).

[30] Sabino Cassese, note 2, p. 13.

increasing role for public ownership of enterprises[31]. In 1942 the Civil Code and its rules on companies were enacted following numerous attempts at company law reform throughout the whole period. As argued by Professor Cassese, economic dirigisme found three expressions in this period[32]. Firstly, whole sectors of the economy such as shipping lines and telephone services (1922), air transport (1923), mining and broadcasting (1927) and waters (1933) became public monopolies. Secondly, access to almost all economic activities (banking, commerce, industry, insurance, export trade) was subjected to authorisation by the government, while the authorisation regimes were often exploited by the incumbents to protect their rents. Thirdly, plans were adopted in areas such as banking, urban development, art and monuments.

4.1 The Great Crisis

In the 30s, a severe crisis occurred as a result of the world economic recession and led to an impressive rescue operation concerning the large universal banks and almost half of the large industrial companies[33]. This operation led to the creation by the Government of the *Istituto per la Ricostruzione Industriale* (IRI) which became the controlling shareholder of several industrial conglomerates (including a number of listed companies) and of the main Italian banks. In addition, a state bank was created under the name of *Istituto Mobiliare Italiano* (IMI) to extend medium and long-term loans to the industry. At the same time, a new banking law was adopted to introduce a tighter system of surveillance and sever the residual links between bank and industry at the ownership level (with the exception of IRI)[34]. Public ownership of business was originally intended as a temporary measure, but it subsequently became a stable solution, characterising our system as a

[31] *Ibidem,* p. 14 et seq.

[32] *Ibidem,* p. 15 et seq.

[33] See, also for references, Patrizio Bianchi, *La rincorsa frenata. L'industria italiana dall'unità nazionale all'unificazione europea* (Bologna, 2002), p. 38 et seq.

[34] See Giuseppe Conti, 'Le banche e il finanziamento industriale', in *Storia d'Italia*, *supra* n.17, p. 483 et seq.

'mixed economy'[35]. Not only several industrial conglomerates, but the prevailing part of our banking system, including all the large banks, were owned by the State until the wave of privatisations in the 1990s.

Capital markets suffered both from the wide role of the State in the economy and from the Fascist Government's policy aimed at reducing the stock exchanges' importance in the financial system[36]. Fascist ideology was uncomfortable with securities markets: centralised government (including tight regulation of banking), the role of the State in the economy, and the isolationism pursued at the international level militated against the formation of vibrant capital markets. Nonetheless, leading industrial figures enjoyed strong connections with the government while their firms prospered under the protection of the same[37]. Controlling private monopolies and coalescing amongst entrepreneurs were keys to economic success in Fascist Italy. As argued by Rajan and Zingales, Italian industrialists benefited from the use of public money in the wake of the Great Depression[38]. The bailouts of industrial firms and banks occurred at enormous costs for the taxpayers. However, many of the acquired enterprises remain listed at the Italian stock exchanges, while the State did not interfere with their management: "not only did the managers keep their jobs, but also many of the board members, who represented the interest of the previous owners, retained

[35] See Fabrizio Barca and Sandro Trento, 'La parabola delle partecipazioni statali: una missione tradita', in Fabrizio Barca (ed.), *Storia del capitalismo italiano dal dopoguerra a oggi,* Roma, 1997, p. 186 et seq.

[36] See Giovanni Siciliano, *supra* n. 26, p. 32 et seq.

[37] See, for example, Sergio Romano, *Giuseppe Volpi. Industria e finanza tra Giolitti e Mussolini* (Venice, 1997).

[38] Raghuram Rajan and Luigi Zingales, note 21, p. 212 et seq. Following Giovanni Toniolo, 'Crisi economica e smobilizzo pubblico delle banche miste (1930-1934)', in Giovanni Toniolo (ed.), *Industria e banca nella grande crisi 1929-1934* (Milan,1978), p. 331, they argue that many of the companies taken over by the government were in capital-intensive sectors and not very attractive economically. Therefore, the private sector continued to obtain the essential inputs needed, without suffering the losses affecting the relevant businesses.

their seats. Public ownership and control was a façade for a much more complex intertwining of the private and the public spheres"[39].

4.2 The Civil Code of 1942

These comments help to put in historical context the reformulation of company law rules in the Civil Code of 1942, which replaced both the Civil Code of 1865 and the Commercial Code of 1882 by unifying private law[40]. The Code's rules were the results of several reform projects which had been elaborated over more than forty years, as the industrial takeoff of the country and the diffusion of joint-stock companies highlighted the limits of the Commercial Code in this area. The main projects were published in the first quarter of the last century and reflected either the need for improved protection of minority shareholders, widely shared by public opinion in the light of financial crisis and scandals *(Vivante* Project, 1922) or the industrialists' wish for the maintenance of the *status quo* under which they enjoyed large freedom of action (*Confindustria*'s Proposals, 1925)[41]. A third initiative tried to mediate between the two opposing camps by adopting only the innovations which were thought to be needed to foster the country's economic development (*D'Amelio* Project, 1925)[42].

However, 15 years had to elapse before the reform activity was resumed, a long delay which can be explained by reference to the conflicting views on company law reform and to the pressure exercised by industrial circles on the Fascist Government. In addition, the public ownership of a large part of the industrial and financial sectors, and a hostile policy towards the stock exchanges combined to play down the need for company law reform. This negatively affected the outline of such a reform, which almost ignored the connection between joint-stock companies and securities markets, and avoided some of the main issues of modern corporate governance, including the

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[39] *Ibidem,* p. 214, making reference also to Mediobanca, the investment bank which, despite being state-owned, had an essential role in protecting principal Italian capitalists.

[40] See, for all, Rosario Nicolò, 'Diritto Civile', XII Enciclopedia del Diritto (Milan: Giuffrè, 1964) …

[41] See Antonio Padoa Schioppa, note 7, p. 226 et seq.

separation between ownership and control in listed companies[43]. On a more general level, "[the] direct intervention of the state as entrepreneur largely replaced and crowded out the role of the private sector in the accumulation of capital. This is at odds with what happened in the United States, where the government faced similar challenges but chose to intervene as regulator of capital markets rather than as their substitute"[44].

As a result, the Civil Code's rules on limited liability companies, despite making a distinction between private companies (*società a responsabilità limitata*) and joint-stock companies (*società per azioni*) so as to better allocate the regulatory burdens depending on the size and importance of the business venture, dedicate an incomplete regulation to the latter type of companies. The limits of the Civil Code were clearly shown, almost fifty years ago, by one of the leading corporate jurists, Tullio Ascarelli, in his inaugural study on the *Rivista delle società*, where he highlighted the wide existence of 'controlling minorities' in listed companies and the ensuing separation of ownership and control[45]. This required, in the author's opinion (explicitly inspired by the Anglo-American experience), improving the internal governance structure of joint-stock companies, reinforcing the shareholders' powers and introducing a public regulator to protect investors in listed companies: measures which were taken by the Italian Legislator only in the last quarter of the last century, as will be shown below.

The Civil Code's fate was similar to that of the Commercial Code, to the extent that not many years after the Code's adoption Italy went through a phase of extraordinary economic

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[42] *Ibidem,* p. 240 et seq.

[43] See Raffaele Teti, 'Imprese, imprenditori e diritto', in *Storia d'Italia, supra* n. 34, p. 1274 et seq., illustrating the lukewarm reception of protection of minorities' principles in the Civil Code, which maintained a corporate governance structure similar to that foreseen by the Commercial Code, despite widespread criticism of the board of statutory auditors (*collegio sindacale*) and proposals to replace it with external auditors.

[44] See Alexander Aganin and Paolo Volpin, 'History of corporate ownership in Italy', ECGI Finance Working Paper No. 17/2003, March 2003, p. 2.

[45] Tullio Ascarelli, 'I problemi delle società anonime per azioni' (1956) Rivista delle società 3 et seq.

development, known as the 'economic miracle'[46]. Industrial productivity increased substantially, also as a consequence of the Common Market's liberalisation policy, and this was reflected by the stock market's exceptional performance in the post-war period[47]. However, despite the stock market's significant contribution to the financing of industry, the former's structural conditions (as measured for instance by the number of listed companies) were left substantially unchanged[48].

4 THE WELFARE STATE AND THE RISE OF SECURITIES REGULATION

The period of time stretching from the middle of the 20th century to the 1970s is characterised by the creation of the welfare State and the completion of the public enterprise system[49]. The welfare State concerns areas such as education, social security and employment. Its importance from a corporate governance perspective was shown, also with respect to Italy, by Professor Roe in his book on the political determinants of corporate governance[50]. The Italian welfare State no doubt contributed to keep the ownership of companies concentrated and the securities markets relatively underdeveloped for reasons which are common to social democracies. As argued by Roe: "Social democracies demeaned shareholder primacy, pushing firms to stabilize employment, to expand whether or not expansion was profitable for shareholders, and to avoid change that would disrupt the quality of the work place. ... Social democratic pressures increased managerial agency costs for shareholders and thus decreased the firm's value to diffuse shareholders. Owners presumably sought alternatives that reduced those agency costs, such as close ownership"[51]. Moreover, the increased role of public ownership reduced the number of enterprises that could assume a diffuse ownership structure as well as the interest for a modern listed

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[46] See, instead of many, Patrizio Bianchi, *supra* n. 33, p. 117 et seq.

[47] See Giovanni Siciliano, *supra* n.26, p. 35 et seq.

[48] *Ibidem,* p. 38.

[49] Sabino Cassese, note 2, p. 19 et seq.

[50] Mark Roe, *Political determinants of corporate governance.* Political Context, Corporate Impact, Oxford, 2003, p.162 ff.

[51] *Ibidem*, p. 27.

companies' regulation. In the following two paragraphs, I analyse the company law reform adopted at the end of the period in question to modernise both the law concerning listed companies and that regulating stock exchanges; I also try to understand the Italian developments examined in this and the previous sections from the viewpoint of the international discussion on corporate governance and financial development.

4.1 The 1974 Reform

The renovated industrial successes of the country in the 50s and 60s threw new light on the inadequacy of the Civil Code's rules on joint-stock companies and led to the formulation of several reform projects[52]. However, T. Ascarelli's proposal[53] of shareholders' empowerment as a means for investor protection was generally rejected. The emphasis was rather put on the distinction between two shareholders' groups in listed companies: those who are interested in the management of the company's enterprise ('shareholders-entrepreneurs', as the controllers or block-holders used to be defined) and those who are only interested in investing ('shareholders-investors')[54]. In particular, it was argued that the shareholders-investors would never be active in corporate governance and would rather vote with their feet, by selling their shares in underperforming companies[55]. As a consequence, the legislator should mainly protect their position as investors, by introducing mandatory rules, improving disclosure and caring for the investors' rights to dividends. Moreover, a public regulator should be created with competencies on corporate disclosure and, under some proposals, on the legality of corporate actions[56].

It was under the influence of these ideas that a reform of company law and stock exchange law took place in 1974. In lieu of focussing on the internal governance of listed companies, this 'small reform' (*miniriforma,* as it was dubbed by the first commentators) sought to implement the

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[52] See, for references, Raffaele Teti, note 43, p. 1284 et seq.

[53] Note 45.

[54] See Giuseppe Ferri, 'La tutela dell'azionista in una prospettiva di riforma' (1961) Rivista delle società 177.

[55] *Ibidem*, p. 185 et seq.

investor protection principle through a number of regulatory innovations[57]. On the one hand, convertible bonds and saving shares (i.e. non-voting preferred shares) were specifically regulated to offer small investors, rather than controlling shareholders, financial instruments which were better suited to their investing goals (an assumption which was proven to be wrong by later developments concerning saving shares). On the other hand, a Securities Commission (*Consob*) was created with competencies on corporate disclosure and stock exchange trading. In addition, information duties were placed on listed companies and companies making recourse to the capital markets. Furthermore, listed companies were required to appoint outside auditors to certify their financial statements, while maintaining a board of statutory auditors as foreseen by general company law.

Therefore, the reform laid the foundations of a securities regulation system[58]. However, its limits were quite clear, even leaving apart the total neglect of internal governance issues. First of all, disclosure regulation was still in its infancy: prospectuses were unknown as were consolidated balance sheets. Consob needed some time to take off and even more time to become a securities regulator deserving this name. Private enforcement was ignored by the 1974 law and also by subsequent laws adding new layers of public regulation. The emphasis on public regulation and surveillance was a reflection of ideologies (both catholic and socialist) not entirely at ease with free market mechanisms. Disclosure regulation was willingly accepted because it foresaw "public controls", while merit regulation frequently surfaced in the discussions leading to the 1974 and subsequent reforms as an alternative way to protect investors. In any case, the architecture of the securities markets was left substantially unmodified: Consob replaced the various institutions governing the stock exchanges, which kept their public nature. Access to the exchanges remained barred to banks and to investment companies, while stockbrokers were forbidden to operate in corporate form and to trade as dealers.

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[56] See Raffaele Teti, note 43, p. 1289 et seq., also for references to the reform projects of the '60s.

[57] See Piergaetano Marchetti, 'Diritto societario e disciplina della concorrenza', in Fabrizio Barca (ed.), *Storia del capitalismo italiano dal dopoguerra a oggi* (Roma, 1997), p. 489 et seq.

On the whole, the mini-reform of 1974 was not directed to promote the securities markets. The introduction of saving shares satisfied the interests of controlling minorities more than those of investors, who were placed at the mercy of dominant shareholders and their managers, as repeated abuses in practice would subsequently prove. Higher dividends were paid to saving shares as investors were not entitled to vote; however, when interest rates came down those dividends became too onerous for issuers and saving shares were generally converted into ordinary shares and almost disappeared. Moreover, corporate governance remained poor as board of directors of listed companies were interlocked and ineffective, whilst statutory auditors devoted little time to their duties and generally lacked independence. In addition, outside auditors were formally regulated by the law and subject to Consob's surveillance; however, the relevant regulation was clearly deficient and public surveillance was too light and sporadic, as subsequently shown by several financial scandals (including Parmalat's unprecedented financial fraud).

4.2 Law and Finance v. Political Theories

The "law and finance" theory explains the underdevelopment of Italian capital markets throughout most of the 20th century as a result of poor investor protection[59]. Whilst the 1882 Commercial Code may have contributed to the extraordinary financial development enjoyed by the country at the turn of the century, its inadequacy in terms of investor protection could help to understand why the stock market did not recover from its 1907 crisis and remained underdeveloped. Also the Civil Code of 1942 was totally inadequate with respect to listed companies and the 1974 law reform introducing Consob was clearly insufficient to introduce a US type securities regulation. All this would confirm the "law and finance" view of the civil law systems as inferior to the common law ones in creating the conditions for securities markets' development.

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[58] See Guido Rossi, *Trasparenze e vergogna. Le società e la borsa* (Milan, 1982), p. 113 et seq.

[59] On this theory in general, see Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Schleifer, and Robert W. Vishny, 'Law and Finance' (1998) 106 J. Pol. Ec. 1113; Eid., 'Corporate Ownership Around the World' (1999) 54 J. Fin. 471.

However, a similar explanation would be only partial. First of all, the "law matters" argument, which is almost undisputable when establishing a correlation between law and financial development, does not necessarily mean that investor protection is necessary for securities markets to arise. As argued by Professor Coffee, the cause and effect sequence is often backwards: legal developments tend to follow, rather than precede, economic change[60]. US legal and financial history shows that securities markets preceded investor protection legislation, also suggesting that securities markets need to develop before a constituency (the dispersed public shareholders) can arise and ask for protection, thus becoming an instrument for legal change[61]. In Italy, securities regulation, despite being introduced in the 70s, was mainly completed in the 90s when the securities market resumed to develop also as a result of the liberalisation of capital flows and integration in European economies, as will be shown below.

The political theory of financial development offers a more comprehensive explanation without necessarily conflicting with the "law and finance" perspective. In particular, the "political economy" view predicts a negative relationship between stock market development and state ownership of companies. Analyzing the evolution of stock market development and public ownership of traded companies over time, Aganin and Volpin found that stagnation of the Italian stock market lasted until the 1980s: "Only in 1985 did the number of companies on the stock market get past the level it had reached in 1930. … While the stock market stagnated, the role of government increased. From 1950 to 1980, between 15 and 20 percent of traded companies in Italy were controlled by the government …"[62]. The situation subsequently changed: the number of listed companies increased (despite remaining relatively low), while the share of publicly owned companies was reduced. This was also the result of privatisations mainly accomplished throughout the 1990s, at a time when the government made serious efforts to promote capital markets in Italy.

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[60] John Coffee, 'The Rise of Dispersed Ownership: The Role of Law and the State in the Separation of Ownership and Control' (2001) 111 Yale L. J. 1, at 7.

[61] *Ibidem.*

Italy's features also display key aspects of Mark Roe's political theory of corporate governance[63]. Under this theory, "strong social democracies pressed firms to favour employees over invested capital, but shareholders resisted this, and their best way to resist was often to build or to keep concentrated, and often private, ownership"[64]. Even though Italy does not entirely fit the model of a social democracy, stakeholders pressures are high in this country and can affect shareholder interests in large firms, particularly those with diffuse ownership[65]. This helps to explain not only the absence of diffuse ownership companies, but also the limited development of Italian capital markets. Only in the 1990s, did antimarket ideologies soften and the economy liberalized enough that it became plausible to think about encouraging securities markets, listed firms and ownership dispersion [66].

To conclude on the Italian developments up to the seventies, the economic dirigisme characterising the welfare State and the increasing role of public ownership of enterprises militated against the securities markets and muted any claim for investor protection. Stock exchanges and listed companies still played a role; however, the markets were thin and dominated by speculation, whilst the capitalists (i.e. the few families controlling the largest quoted groups often through pyramids and the like) resisted change fearing that the development of vibrant capital markets could threaten their rents. All this was possible because national markets in Europe were still relatively closed and regulatory barriers existed to the circulation of capital (including rigid currency controls). As argued by Rajan and Zingales, incumbents find financial development less useful when an economy becomes open to the entry of foreign goods and capital[67]. First of all, there are fewer profits to protect in the system. Consequently, both the incentive to keep restraints in

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[62] Alexander Aganin and Paolo Volpin, note 44, p. 10.

[63] See Mark Roe, note 50.

[64] *Ibidem,* p. 14.

[65] *Ibidem,* p. 24.

[66] *Ibidem,* p. 83.

[67] Raghuram Rajan and Luigi Zingales, note 21, p. 182 f.

place and the ability to pay politicians for support diminish[68]. Furthermore, even established incumbents find that the high costs of domestic finance hurt and so become supporters of financial development[69].

5 THE NEW ECONOMIC CONSTITUTION AND COMPANY LAW REFORM

Better conditions for financial development matured in Italy throughout the last two decades of the 20th century under the "new economic constitution"[70]. This concept includes the main legal developments occurred both in the EU and Italy in the relevant time. First of all, the internal market was completed through implementation of the fundamental freedoms foreseen by the EC Treaty. In addition, a rigorous competition policy was developed by the Union as a means for the integration of markets. Specific liberalization measures were adopted as to banks, financial intermediaries, insurance undertakings and public utilities, in order to enhance competition and harmonize regulation so as to allow the formation of a single market. This led to the formation of new regulatory structures in the Member States along the US model of independent regulatory commissions and to the re-organization of existing ones. In this paragraph, I will consider the main changes occurred in Italy in the relevant period with respect to securities regulation and corporate governance reform also as a reflection of European developments.

5.1 Improving Securities Regulation

Liberalization of capital movements by the European Community in the 1980s was clearly instrumental to eliminate resistance to securities market's development, as the Italian market was integrated into the single European market and subject to harmonized rules. In addition, the privatisation program led by the Italian government throughout the 90s widened the shareholders' base in large companies and enhanced the stock market's liquidity. Privatisations were also

[68] *Ibidem,* p. 183.

[69] *Ibidem.*

[70] See Sabino Cassese, note 2, p. 283 et seq.

motivated by developments occurring at EU level such as the criteria laid down in the Maastricht Treaty for qualifying for the Monetary Union and the EU prohibition of government subsidies to enterprises including state-owned companies[71]. More recently, the introduction of the Euro gave further impetus to the integration of European securities markets and motivated new harmonisation initiatives at EU level such as those included in the Financial Services Action Plan.

As a result of these and similar developments, Italian securities regulation was radically transformed. The main changes took place in the 90s. In 1991, insider trading was forbidden in compliance with the relevant EC Directive. In the same year, investment companies (*società di intermediazione mobiliare*) were introduced into our legal system to operate as multifunctional intermediaries replacing individual stock-brokers (*agenti di cambio*), who could only act in a broking capacity. At the same time, the conditions were laid down for a re-organisation of the regional stock-exchanges through their merger into a national stock-exchange (in fact, the Milan bourse which was already dominant became the Italian Stock Exchange). In 1992, takeovers were regulated and a mandatory bid rule was introduced to protect minority shareholders albeit in a rather confused and incomplete manner.

In 1996, another important reform took place when the Investment Services Directive was implemented. Not only were the ISD rules received into our law, but other rules were introduced to allow the Italian market to better sustain the impact of liberalisation. Stock-exchanges' organisation was radically reformed and privatisation of the existing exchanges was envisaged. Exchanges came to be treated as enterprises offering trading services, whilst exchange trading became subject to these enterprises' regulation (not necessarily "self-regulation", as the exchange owners could be different from either the market intermediaries or the financial instruments' issuers). As a result,

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[71] Raghuram Rajan and Luigi Zingales, note 21, p. 216.

both the Italian Exchange and MTS (the sovereign bonds market) became for-profit companies and were sold to investors, mainly banks and investment firms operating in the relevant markets [72].

5.2 The Draghi Law

The 1996 rules on investment intermediaries and markets were almost transplanted into the Financial Markets Consolidated Act of 1998, also known as the Draghi Law after its Drafting Committee's Chairman. This Law also included new rules as to listed companies' disclosure and governance. In fact, the emphasis placed on corporate governance at the international level, both in practice and academia, made the 1974 reform appear inadequate, as it undervalued the internal governance of listed companies by focussing on disclosure and public regulation. While these two aspects still deserved consideration and improvement, also the corporate governance structure of listed companies needed upgrading. The Draghi Law handled the matter from within a broader framework of capital market law consolidation. First of all, the law strengthened the board of statutory auditors' (*collegio sindacale*) powers and responsibilities, so as to enhance its monitoring over the company's management by the executive directors and the board of directors[73]. This part of the reform echoed the Anglo-American discussion on the role of non-executive directors, audit committees and internal controls. However, convergence was functional rather than formal[74]. Instead of replacing the traditional board of statutory auditors with an audit committee made up of non-executive directors, the Draghi Law made the former institution appear similar to the latter from a functional perspective. Moreover, the law reinforced minority shareholders' powers, introducing, *inter alia*, the right of a qualified minority (5 per cent) to sue the directors for damages caused to the company. In addition, the Draghi Law aimed to promote corporate control

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[72] See, also for references, Guido Ferrarini, 'La riforma dei mercati finanziari e il testo unico', in Guido Ferrarini and Piergaetano Marchetti (Eds.), *La riforma dei mercati finanziari* (Milan, 1998), p. 25 et seq.

[73] Italian governance structure consists of a board of directors and a board of statutory auditors, despite the fact that in listed companies accounting audits are performed by external auditors.

[74] On the two types of convergence, see Ron Gilson, 'Globalizing Corporate Governance: Convergence of Form or Function' (2001) 49 Am. J. Comp. L. 329.

contestability in listed companies by attributing members of shareholders' agreements the right to withdraw from the same in case of a takeover bid, so as to tender their shares to the bidder. This provision, together with other rules on takeovers, reflected the Draghi Law's additional concern for the external governance of listed companies and marked an important change in the Italian system, which had traditionally favoured corporate control stability over contestabilty[75].

The changes effected by the Draghi Law are particularly significant if the index of shareholder protection used by La Porta et al. is considered[76]. While in 1994, Italy was still ranked amongst the industrialized countries with the lowest legal protection for investors, as anti-director rights scored a meagre 1 out of 6, the impact of the 1998 reform was an improvement in shareholder protection from 1 to 5[77]. However, as noted by Professor Coffee, "the specific 'anti-director' rights that they [La Porta et al.] identify as the central factors … strike many legal commentators as only tangentially related to effective legal protection for minority shareholders'[78]. Moreover, recent work by La Porta et al. on investor protection in 49 countries attributes to Italy (and to other "French legal origin" countries) low scores as to private and public enforcement of securities laws [79]. Whilst the criteria used by these authors may once again be only partial and disputable, the overall assessment of securities law enforcement in Italy more or less coincides with a widely shared opinion amongst practitioners particularly after the recent financial scandals (see para. 5.4 below). Furthermore, strong indicia as to the low impact of the Draghi law on the development of the Italian capital market could be found in the modest increases, after enactment

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[75] For an analysis of the philosophy of the Draghi Law see Piergaetano Marchetti, 'Osservazioni sui profili societari della bozza di TU dei mercati finanziari' (1998) Rivista delle società 140.

[76] See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Schleifer, and Robert W. Vishny, *supra* note 59.

[77] Alexander Aganin and Paolo Volpin, note 44, p. 7.

[78] John Coffee, note 60, at 8 and note 6, where the author critically analyzes the anti-director rights selected by La Porta et al. to assess minorities' protection and concludes: "By no means it is here implied that these rights are unimportant, but they seem to supply only partial and sometimes easily outflanked safeguards, which have little to do with the protection of control and the entitlement to a control premium".

[79] Rafael La Porta, Florencio Lopez de Silanes, and Andrei Shleifer, 'What Works in Securities Laws?', Tuck School of Business at Dartmouth, Working Paper No. 03-22, July 16, 2003.

of the same, of the number of listed companies (which went from 239 in 1997 to 279 in 2003, including the 41 companies listed on the New Market for technology stocks) and of the ratio of stock market capitalisation to GDP (which moved from 30.7% in 1997 to 37.6% in 2003, after reaching 70.3% at the heights of the world equity markets in 2000)[80].

5.3 The Recent Company Law Reform

By reforming the corporate governance of listed companies, the Draghi Law widened the regulatory differences between listed and unlisted companies and added arguments to the criticism of traditional company law. An extensive overhaul of the limited liability company rules was then conducted on the basis of a 2001 law empowering the Italian Government to adopt a reform the principles of which were loosely fixed by the same law[81]. Among these principles is a clearer distinction between private companies (*società a responsabilità limitata*) and joint-stock companies (*società per azioni*). As to the former, the regime previously in force was deregulated to the extent necessary to simplify the formation of these companies and allow more freedom in their organisation, so as to reflect their nature of closed companies. As to joint-stock companies, the relevant rules were reformulated on the assumption that these companies can make recourse to the equity markets, while stricter rules are applicable to the same companies if they actually do so, thus becoming 'public companies'. Also the joint-stock companies' regime has been, at least in part, deregulated and simplified. Moreover, three new governance structures are now available: one reflecting the structure presently in force, which consists of a board of directors and a board of

[80] For the data, see Borsa Italiana, *Fatti e cifre 2003* (Milan, 2004), p. 81. For an assessment similar to that given above in the text, see Bernardo Bortolotti and Domenico Siniscalco, 'Importare la *corporate governance*?', in Centro Nazionale di Prevenzione e Difesa Sociale, *Le nuove funzioni degli organi societari: verso la corporate governance?* (Milan, 2002), p.120 et seq.

[81] See, in particular, the Legislative Decree No. 6/2003, carrying the substantive company law reform and amending the relevant Civil Code provisions; for a commentary in English, see Guido Ferrarini, Paolo Giudici, and Mario Stella Richter, 'Company Law Reform in Italy: Real Progress?', paper presented at a Conference on Company Law Reform in Europe organized by the Society of friends of Max-Plack-Institute for International and Comparative Private Law, Hambourg, June 2004 (forthcoming in the Conference proceedings).

statutory auditors (in addition to external auditors auditing the company's accounts); another reflecting the German two-tier structure, however adapted to the Italian context; and a third one inspired by the Anglo-Saxon unitary board, with a majority of independent directors and a mandatory audit committee. The possibility to choose between these three different systems is intended as a substitute to regulatory competition, as the choice, for example, of the unitary board might work functionally as a (partial) equivalent to the choice of U.K. Law.

It is difficult to assess the impact of the new law on Italian corporate governance so short a time after its adoption. However, an assessment recently made from the perspective of global and European trends in company law reform concluded that, at least with regard to public companies, the Italian legislator did not generally follow these trends and in some cases adopted solutions designed to relax, rather than reinforce minority shareholders' protection[82]. Examples would be offered *inter alia* by the transfer of powers from the shareholders' meeting to the board of directors (for instance, as to issuance of bonds), by the limitations introduced as to the possibility for minorities to plead for the annulment of shareholders' resolutions, and by the options introduced as to the choice between governance systems (which could result in a relaxation of internal controls if the unitary model were chosen to the preference of the traditional Italian model). These innovations would be directed, according to the study in question, to reinforce the controlling shareholders, whilst other novelties of the reform, such as the greater reliance on private autonomy and the narrower scope for mandatory provisions, would be based on an excessive faith in the equity markets also considering the limited development of the Italian stock market[83]. Nonetheless, some aspects of the reform - such as the deregulation of shares, bonds and hybrids - deserve approval, even though the impact of liberalisation should not be exaggerated as there are limits to financial

[82] See Guido Rossi and Alessandra Stabilini, 'Virtù del mercato e scetticismo delle regole: appunti a margine della riforma del diritto societario' (2003) Riv. Soc. 1.

[83] *Ibidem,* at 27 et seq.

innovation whilst market practices tend to be uniform internationally[84]. Therefore, de-regulation should help to integrate the Italian capital market into the global markets, but no radical transformation is to be expected also considering that 'one share-one vote' is the benchmark of today's corporate governance. Moreover, the de-regulation of bonds might cause problems as fraudulent issuers could exploit it to avoid creditors' monitoring, as shown by the Parmalat scandal[85].

As to corporate governance, some diversity could be introduced if joint-stock companies adopted either the one-tier or the two-tier model in lieu of the traditional Italian system. However, the differences amongst the three systems as defined by the Italian reform are very limited so that it is difficult to envisage a widespread recourse to either of the two new models. On the contrary, path dependency could favour adherence to the traditional system which is intertwined with other features of the Italian tradition, such as a powerful accounting profession dominating the statutory boards of auditors[86]. In any case, the "softening" of directors´ fiduciary duties and of their liability for violation of these duties might launch the wrong signal to both the national and international business community, if it were interpreted as a relaxation of the relevant rules despite the recent financial scandals.

5.4 Financial Scandals and the Need for Further Reforms

While the company law reform was being enacted, serious financial frauds - including those concerning Parmalat's false accounts and the ensuing record losses to investors in this company's shares and bonds [87] - were brought to light and were widely investigated. This was clearly a blow to the company law reform which had been conceived of with reference to a different scenario

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[84] See Guido Ferrarini, Paolo Giudici and Mario Stella-Richter, *supra* note 81, section II.1.

[85] On the use of bonds to elude the monitoring of banks and creditors in general, see Guido Ferrarini and Paolo Giudici, 'The Parmalat Scandal: Gatekeepers and the Role of Private Enforcement', ECGI Law Working Paper (forthcoming).

[86] See Guido Ferrarini, Paolo Giudici and Mario Stella-Richter, *supra* note 81, section II.2.

[87] See Guido Ferrarini and Paolo Giudici, *supra* note 85.

assuming that listed companies and their disclosure to investors were sufficiently regulated, whilst other companies needed a legislative upgrading of the rules concerning shareholders' protection along the model of the Draghi law. The recent scandals showed that corporate governance and disclosure rules, despite their convergence towards international best practices, were insufficiently enforced. Poor enforcement resulted in macroscopic failures of internal controls and in gatekeepers' failures of the kind experimented either by Parmalat's auditors or by first-class banks placing securities issued by companies on the verge of bankruptcy (such as Cirio and once again Parmalat). The scandals also made clear that Italian regulation of auditors is inadequate to the extent that Consob, the public regulator, almost blindly relies on the work done by auditing companies with respect to audited issuers, rather than periodically controlling the quality of the audit work. In fact, inspections of auditing companies and other surveillance activities generally react to irregularities once found, rather than being directed to the timely discovery of the same (not surprisingly Parmalat's accounting and auditing frauds went undetected for years). The Italian Parliament is now considering a draft law on investor protection which should deal with some of the problems evidenced by the recent scandals[88].

6 CONCLUSIONS

The 1882 Commercial Code carried remarkable regulatory novelties and liberalised the companies' formation by suppressing the administrative controls foreseen by previous legislation. Liberalisation was no doubt instrumental to rapid economic development at the turn of the century, when Italy joined the second industrial revolution. In general, market-openness favoured economic and financial development in the first part of the 20th century and Italy was no exception to international trends. However, the diffusion of limited liability companies and the listing of their shares on the stock exchanges created problems which the Commercial Code was inadequate to

[88] For a critical perspective on the original draft, see Guido Ferrarini, 'Informazione societaria: quale riforma dopo gli scandali?' (2004) Banca, Impresa, Società (forthcoming).

cope with. These problems also depended on the governance structures of Italian companies, which were already dominated by minority shareholders through cross-holdings, voting pacts and pyramidal groups, while small shareholders were largely passive. In addition, German-type universal banks concurred to the control of companies either directly or as proxies of their clients[89].

An important feature of Italian corporate governance was the role played by the State in economic development. Initially this role was limited to supporting industrial growth through protectionism, subsidies and the supply of goods and services to the State by private firms. At a later stage, the same role was extended through the acquisition of banks and industrial companies by the State. This had an influence on company law reform and its repeated postponements, because public ownership of large sectors of the economy, as well as the equity markets' limited role in the financing of industry, made company law modernisation less important from a policy perspective. In addition, the incumbent capitalists benefited from the State's occupation of large sectors of the economy and also from the limited role of securities markets, as shown by Rajan and Zingales and the other scholars cited above. As a result, the rules on joint-stock companies, which were included in the Civil Code of 1942 following private law unification, were very mild in protecting minorities and largely ignored the joint-stock companies' role in the capital markets. More than thirty years elapsed before the introduction of disclosure rules for listed companies and of a securities regulator.

Corporate governance reform was delayed until the end of the '90s, while a general reform of company law was enacted in 2003. This is also a reflection of a new stage of financial development started in the 90s as a consequence of trade liberalisation both in the EC and worldwide. In fact, the Italian legal developments found their equivalents in other EU Member States and were also the outcome of European harmonisation and liberalisation policies. The Draghi

[89] While banking law reform in the '30s operated to sever the links between banks and industries, other corporate governance features that first appeared at the beginning of the last century were carried over to the present times: see Marcello Bianchi, Magda Bianco and Luca Enriques, 'Pyramidal Groups and the Separation between Ownership and Control in Italy', in Fabrizio Barca and Marco Becht (Eds.), *The Control of Corporate Europe* (Oxford, 2001), p. 154 et seq.

Law, in particular, took care of the listed companies' internal governance, by enhancing the board of auditors' role in the quasi-two-tier structure typical of Italian joint-stock companies and by reinforcing minority shareholders' powers. Also the external governance of listed companies was dealt with by the Draghi Law, aiming to lower barriers to corporate control contestability and improve the role of the corporate control market. On the whole, this law tried to modernise the listed companies' rules taking into account the traditional aspects of Italian corporate governance, such as ownership concentration, pyramidal groups and shareholders' coalitions through voting agreements. In the new century, general company law reform revised the joint stock companies' rules, along the lines of the Draghi Law and also for aspects not covered by the latter, while a new regime was adopted for private companies to meet the needs of small and medium enterprises, which still represent the backbone of the Italian economy.

However, astounding financial scandals showed that even the recent reforms are based on shaky foundations, to the extent that both public and private enforcement are weak, particularly with respect to listed companies, and were not touched upon by either the Draghi Law or the new company legislation. This is proof of path-dependency, as the weakness of private enforcement largely depends on the notorious dysfunctions of the Italian judicial system, which appear very difficult to cure also due to the resistance of powerful interest groups (including the judiciary). What is more, the limits of public regulation and surveillance which were uncovered by the recent scandals are well rooted in the Italian tradition and are likely symptoms of difficulties in transplanting the US model of regulatory agencies into a Continental European context.

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