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Continuity and Change in Italian Corporate Governance: The Institutional Stability of One Variety of Capitalism

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Abstract - For a long time family capitalism has been considered to be one of the distinguishing characteristic of the Italian economy. In Italy also large business organizations rely very often on this form of corporate governance. This paper examines both the actual institutional shocks and the missed opportunity for institutional shocks that have diversified the Italian economy from the other advanced capitalist economies. We maintain that, in the midst of the numerous changes that have characterized the last ten years, the strong presence of families in the governance of large enterprises has been an important aspect of systemic continuity. Despite the intentions of the reformers, the Italian model of family capitalism has been even purified to the point that it has come to approach a sort of Weberian ideal-type. Indeed, the role of other spurious (but, perhaps, complementary) institutions has been dramatically reduced with the eclipse of the power of Mediobanca and the privatization of the State sector while no serious challenge has threatened the dominance of family capitalism.

JEL Classification: N2, O1, P1, P5

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1. Introduction.

The crucial economic role of the family has been one of the strongest elements of continuity in the extraordinary changes that have characterized Italian society in the last hundred years.

This observation has been largely included in the stereotype of the "typical" Italian and has not escaped the attention of sociologists and historians concerned with the Italian society.

For instance, Francis Fukujama (1995) views the central role of the family as a typical feature of "low thrust societies" that are unable to expand the size of their networks and organizations beyond the elementary thrust relations that characterize immediate family relations. In other words, according to Fukujama the limitations of alternative sources of thrust (rather than the relative strength of Italian family networks) explain the intensive adoption of family based organizations. Also Paul Ginsborg (1990) has observed how the relations between family and society are an important key to understand post-war Italian history. However, according to Ginsborg, the intensity of Italian family relations is not only to be seen as an alternative to more extended thrust relations. While the "familismo amorale" can lead to some disregard for wider social interests, it can also push family members to undertake collective actions characterized by some generous identification with the problems of other families.

With reference to the topic of this paper the importance of the role of the family is also very clear. Italy's form of "family capitalism" is, perhaps, a rather unique case among the industrialised countries where the largest firms are not usually run by family dynasties. It is true that small and medium firms as well as large new firms are usually run by families also outside Italy. However, what is peculiar to the Italian system of corporate governance is that in large firms control is passed more along family lines than through a mechanism of managerial meritocracy. Moreover, Italy is no exception in the sense that most capitalist countries have gone through a phase of family capitalism. However, the Italian experience is again rather different because this phase has never been overcome and no form of "managerial capitalism" has ever evolved. Thus, the question remains why in Italy large organizations have tended to stay under family control and why none of the alternative forms of capitalism has ever emerged. In this respect, the alleged Italian love for family may matter very little.

The structure of this paper is as follows.

The first section we will analyze of the relationship of Fiat and the Agnelli family. This is more than a case study because Fiat and Agnelli account for such a disproportionate fraction of Italian capitalism. We will see that the cycle “Giovanni Agnelli(jr)-Romiti-John Elkan" tends to repeat the earlier cycle “Giovanni Agnelli(sn)-Valletta-Giovanni Agnelli (jr)". In both cases a direct succession link between grandchildren and grandparents seems to solve some intergenerational tensions between father and children, while in the gap left by the intermediate generation non-family managers tend to acquire an important role. External intervention in the imposition of external managers characterized the second cycle although it was absent in the first. In this sense the vanishing power of Mediobanca may, in this respect, imply a return to the early "pure model" of family capitalism.

In the second, third and fourth sections we will try to explain at a more theoretical level why different models of capitalism may co-exist and how the transition from one form of capitalism to the other tends to occur after major institutional shocks or in countries where the preceding organizational forms were relatively weaker.

The last three sections consider three different phases of Italian capitalism.

The fifth section consider the changes that characterized Italian corporate governance between the two world wars when a "bank-based system of corporate governance" was replaced by a sort of co-habitation between "family capitalism" and State-owned enterprises.

The sixth section considers the missed opportunities of the post-war period when family capitalism was not replaced but rather regulated and reinforced (sometimes rescued) by institutions like Mediobanca, and when State-owned enterprises continued to play a very important role in Italy's economic development.

Finally, the last section considers the nineties when privatization was intended to be linked to both the dismantling of State ownership and the birth of a new model of corporate governance. While a massive programme of privatisation took place, in the midst of such major change the continuity of the model of family capitalism remained unbroken. Indeed, in many respects, with the end of the role of State-owned enterprises and the dramatic eclipse of the power of Mediobanca, the system of family capitalism has been "purified" and looks like a Weberian ideal-type. We conclude by observing that the purity of the model may contrast with its institutional stability that requires the contribution of specific complementary institutions.

2. Italian family capitalism: the case of Fiat

On 16 December 1945 Giovanni Agnelli, the founder of Fiat and the grandfather of the present honorary president of Fiat "Gianni" Agnelli died at the age of 79. Ten years previously his son Edoardo Agnelli had died in a plane accident. At the time of his grandfather’s death Gianni, the eldest of Edoardo's sons, was 24 years old. He was clearly unprepared to take over his grandfather's job. The top Fiat manager was at that time Professor Vittorio Valletta. One Fiat executive remembers that during the difficult years of the war "Valletta always said we would be good Germans, we would be good Fascists, but we had to save Fiat. That was the policy" (Friedman, 1989 p. 36).

After Giovanni Agnelli’s death Valletta told Gianni that there were two possibilities: either the young Agnelli or Valletta himself must become the president of the company. According to Alan Friedman's account, the young Agnelli, who did not consider himself ready for the job, replied, "You do it Professor". What followed was a period that is known as "The season of Valletta" or alternatively as the "Regency". The relationship between young Agnelli and Professor Valletta was indeed very similar to that of an absent sovereign and his regent. "While Gianni spent his time on fast cars and loose women, Valletta was very much in control of the Fiat Empire, overseeing its reconstruction in the post-war period. Agnelli might have ruled from a distance, but Valletta governed (Friedman, 1989 p. 44)."

Valletta's regency ended in 1966. During his season Fiat had enormously prospered. At the time of Giovanni Agnelli's death, Fiat was producing 3260 automobiles a year. In 1966, Fiat was turning out that number of cars every working day. By the year 1974, the direct involvement of Gianni Agnelli and his young brother, Umberto, was one of the factors that had precipitated FIAT into a serious crisis. While Umberto had consistently shown very poor skills, Gianni had, with comparable consistency, proven to be a better ambassador for Fiat than a manager. With Fiat in a mess, young Umberto tried to pursue a political career. This created the opportunity to appoint Carlo De Benedetti - who was later to become the president of Olivetti, - as managing director. After a short time, Umberto had to give up his hopes of a successful electoral career and expressed his desire to return to his FIAT job. "De Benedetti had finally to understand what everyone already knew, that for the Agnellis, Fiat was more than a company to be run on strictly business grounds. It was family property, where matters such as keeping a dilettante brother happy were more important than a company clean up. De Benedetti realised then that there was nothing more he could offer in the group"(Friedman, 1989 p.78).

Leaving the company to find his own way as an independent entrepreneur, De Benedetti predicted that the day was not far off when Fiat could not no longer be run so incompetently. That day came in 1980 when the survival itself of Fiat as an independent company was at stake. Umberto finally gave up and admitted that he was not the man to run the company. Cesare Romiti, a manager who, before working at Fiat, had shown his skills in the public sector was placed firmly in the driving seat by Mediobanca in exchange for the financial support of FIAT. Mediobanca[1] president Enrico Cuccia emerged even more clearly as the "master of the masters" and as the supreme authority regulating the transmission of power from one generation to the other. He had also acquired the right to give control to external managers when children and brothers were judged to be unsuited for the jobs that had been performed by their older relatives. The solution was accepted but with outrage over this external interference.

The combination of the diplomatic skills of Gianni Agnelli and the managerial skills of the tough Romiti was unvincible. Gianni Agnelli had finally found his new Valletta. Together they expanded the frontiers of the Agnelli power network. Soon, the Agnelli group controlled one quarter of the Milan stock exchange making free use of the clout that derived from its 569 subsidiaries and 190 associated companies. Gianni Agnelli became the single most powerful individual in Italy and, according to Alan Friedman the uncrowned king of the nation.

In the midst of so much success many problems emerged. Umberto's son, Giovannino Agnelli, the designated new head of the family died of cancer in 1997. Edoardo,

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[1] More on Mediobanca on section 6.

Giovanni Agnelli's own son, had always preferred meditation and Indian asceticism to the demanding family job and, in any case, committed suicide few years after Giovannino's death. The relationship with Romiti had never been an easy one and finally soured when he left Fiat.

While the world was changing and Fiat was forced to tighten its relations with GM, also the "master of the masters" Enrico Cuccia finally died in 2000, at the age of 92. With the power eclipse of Mediobanca and the tragedies that had swept away the intermediate generations, Giovanni Agnelli could only hope to do with his young grandson (John Elkan) what his own grandfather had done with him. The cycle could now be repeated. Power could again be passed from grandfather to grandchild, leaping one generation. This transmission could occur, as in the old days, without the interference of institutions like Mediobanca. Nobody (outside the family) was there to judge the qualifications or check the quality of the new master's performance.

3. The diversity of business organizations: a theory of the relevance of institutional shocks.

Iwai (1999) has observed how, even when legal differences are not relevant the modern corporation is compatible with different organizational forms. The modern corporation is based on a double ownership relationship. On the one hand, the corporation is a legal person that owns other assets as things. On the other hand the corporation is owned by others as a thing. This Janus-like form of the corporation implies that two extreme cases are possible. At one extreme, the corporation may be controlled by one person and can be completely treated as a thing with no discretional autonomy independent from this particular physical person. At the other extreme, the corporation may become a self-referential being (in some ways a "proper person", characterised by self-ownership and not just a "legal person"!) that owns its own assets buying back some of its shares. In a paper that we have co-authored with Barca and Iwai[2] we show that while both extremes are theoretical abstractions, post-war Italian and Japanese firms have tended until recently to be relatively closer to each of these two extremes. Italian firms, pyramidal in structure, with families like the Agnelli at the apex, tend to approach most closely a situation where the corporation is just a thing in the hands of the family. By contrast, Japanese firms, with their cross-shareholding occurring within their *keiretsu* groups, have often approximated a situation where the *keiretsu,* taken as whole, could easily own the majority of its own shares. Thus, although located at two opposite extremes, both Italian and Japanese corporations share the characteristic of being somehow "protected" from hostile take-overs - a feature that would distinguishes them from them from the Anglo-American corporation.

In our paper with Barca and Iwai (1999) we explained these deviations of Japan and Italian corporations from the standard Anglo-American model towards opposite extremes by

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[2] See Barca, Iwai, Pagano Trento(1999).

pointing out that both Italy and Japan were subject in the immediate post-war period to opposite institutional shocks.

There is little in standard economic theory that can help us to explain why institutional shocks such as the American occupation should have had such a lasting impact on the organizational arrangements of Italy and Japan.

In the Neo-Classical framework, the entire issue of ownership and control rights[3] does not make sense[4]. In a world of perfect competition and zero market transaction costs, agents could write a complete contract that specifies the conditions under which they participate to coalition of agents producing a certain good. In this framework, the assignment of control rights does not matter: there are no ex-post residual decisions left by the ex-ante contract, where the power entailed by the control of the organizations could be exercised.

In the New Institutional and in the New Property Rights framework, the assumption of costly and/or incomplete contracts implies that some relevant ex-post residual decisions may be left to the holders of ownership. In this framework, the assignment of control rights does matter and the choice of individual who will employ other individuals is relevant to organization efficiency. In a second best world, some agency costs are likely to be sustained by any individuals controlling the firm which must employ other individuals. Because of the specificity of other investments each individual will have to share the fruits of its investment with other agents who can threaten to leave the coalition. Moreover, because of asymmetric information, each agent will have to sustain some (monitoring and/or bonding) costs. Thus, in comparison to the first best solution, no agent can obtain the whole fruits of its investments and therefore tends to underinvest. The "second best" solution is to assign control rights to those agents who imply the highest agency costs when they are to be employed by other agents. In a market characterized by zero transaction costs this second best solution should always be attained.

In this second best framework, the re-assignments of ownership and control rights that occurred under the American occupation should be irrelevant. If the new rights implied lower agency costs, they would have occurred independently of the American occupation whereas if they implied higher agency costs they would have been undone by the market after the end of the political constraints created by the occupation. In both cases, institutional shocks are irrelevant and the control of the organization would go to the high-agency-cost agents.

The relevance of institutional shocks becomes, instead, evident if we move beyond the New Institutional and the New Property Rights framework and acknowledge that in a

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3 Let us for now use the two as synonymous.

4 The neo-classical model is also characterised by a very restrictive vision of individual preferences. In this framework preferences for work (Pagano, 1985) and preferences related to self-definition (Pagano, 1995) and identity are not considered satisfactorily. By contrast, they play a very important role in determining the success of the organizations and, more in general, the outcome of the complex historical events that are the object of this paper.

zero-transaction-cost-world, where the control of firm does matter, it is inconsistent to assume the existence of a costless perfect market for control itself. Three distinct problems arise in such a world whereby institutional changes come to have a decisive influence on the allocation of control rights.

i) Information problems. Due to asymmetric and imperfect information concerning who the highest-agency-costs individuals actually are, efficiency enhancing transfers of control might not take place and efficiency - reducing ones might well take place. As the result of this market failure, institutional shocks, which either directly or indirectly bring about a forceful reallocation of control, can indeed make a difference by changing the default - no transfer - option.

ii) Multiplicity of organizational equilibria. Technology (i.e. the degree of specificity and the difficulty of monitoring individuals) is not to be taken exogenously but is rather influenced by control allocation. Multiple combinations of technological and control allocation can then exist. Institutional shocks, by transferring control rights, can therefore permanently shift the economy from one equilibrium to another.

iii) Separation between ownership and control. The allocation of wealth among members of a society does not necessarily coincide with the allocation of "skills" (specificity and difficulty of monitoring). Therefore, control must separate itself from ownership and institutions are needed to sustain this separation; alternative institutions arranged in "property-rights systems" or, as they are now called, "corporate governance systems", can achieve separation in different ways and with different effects on the allocation of rights [as well as an the content of such rights]. A diversity of corporations arises as it was made clear in the previous section. As a result of that, institutional shocks can permanently move the system from one corporate governance to another, from one kind of corporation to another, and also an effect the allocation of rights.

While point (i) is well known we need to consider the latter two issues in more detail.

Multiplicity of organizational equilibria. In some ways, different given systems of property rights have an effect similar to different systems of relative prices. A change in the property rights increases the agency costs of using the non-owning factors relatively to those of the owning factors. Thus, similarly to changes in relative prices, changes in property rights have a substitution effect: the high-agency-cost resources of the non-owning individuals tend to be substituted away; for this reason non-owning factors tend to become low-agency-cost resources. Or, in other words, they tend to become less firm-specific and more difficult-to-monitor than owning factors. Thus, the effects of property rights on the technological specification of the resources, which have been typically advanced by "Radical economists", can be explained by a substitution effect similar to the one determining input composition in standard microeconomic theory.

The relationships considered by many New Institutional and New Property Rights economists can be inverted along the lines suggested by the Radical economists[5]. According to the former, the ownership of the firms is to be given to the factors which involve the highest agency costs, that is, to the most difficult to monitor and specific factors. However, as "radical economists" have suggested, it can also be argued that owning factors will tend to save on these agency costs and, because of a standard substitution mechanism, will tend to become relatively more specific and difficult to monitor. Thus, according to the radical mechanism, owning factors tend to choose that technology under which, according to New Institutional theory, their ownership is to be preferred. In this way, initial ownership conditions tend to sustain themselves via the technology that it is optimal to sustain under those conditions. This self-reinforcing mechanism is consistent with the idea that initial property rights shocks, such as those due to the American occupation, could in principle have had a lasting effect.

Indeed, the two mechanisms considered above are not mutually exclusive and can be combined together since causation may flow in both directions at once: while technology influences the allocation of property rights, ownership influences the choice of the technology. This two-way-causation can generate multiple "organizational equilibria"[6] and major institutional shocks, such as the American occupation may shift the economy from one organizational equilibrium to the other.

An "organizational equilibrium" can be defined as any combination of property rights and technology that has the following characteristics. With the given property rights, the current technology is the most efficient available; conversely, with this technology, the current property rights are most efficient. In such an equilibrium, property rights and technology are self-reinforcing since changing one component at a time damages efficiency, and hence reduces the total income available for distribution among the various parties.

Can competition imply that, independently of initial conditions given by the history of the economy, the market selects the most efficient organizational equilibrium?

While this is a possible outcome, we argue that the effects of market selection may turn out to be rather ambiguous. Indeed, there are some circumstances in which competition may enhance stabilization instead of upsetting an inefficient organizational equilibrium.

The complementarity between property rights and technology, characterizing an organizational equilibrium, inhibits the possibility of a gradual evolution from one equilibrium to another; the inferiority of hybrids implies that the transition from one type of equilibrium to another is likely to be abrupt and that evolution will have a punctuated character[7]. The inferiority of hybrids also implies that competition may have a negative

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5 See Pagano (1993).

6 The formal properties of organizational equilibria are examined in Pagano (1993) and in Pagano and Rowthorn (1994) and (1995).

7 See section 7 of Pagano and Rowthorn (1995).

effect, wiping out the necessarily inferior hybrids before they may transform themselves into superior organizational equilibria.

In some respects the role of market selection is analogous to that of natural selection. While it favours the selection of the best members of a given species of organizations, it may inhibit the speciation of new organizational arrangements. This analogy is reinforced by the observation that in natural history the efficiency of each species depends on its frequency. Also "organizational species" share the same characteristic. Network externalities in property rights and in technologies may imply that few firms characterized by different organizational equilibria are not viable: they would be out competed by firms that, even if inferior when they exist with the same frequency, can better benefit from network externalities because of their current large number.

In other words, the successful speciation of new organizational equilibria does not only require that each firm deal successfully with the complementarities between its own rights and technology. Because of network externalities, there are also important complementarities among the organizational models adopted by different firms.

The existence of network externalities can cause a homogenisation of technology[8]. A single technological standard may be the only possible equilibrium outcome when common inputs, produced under a regime of economies to scale, are used by all the firms.

Network externalities can also cause the homogenization of ownership systems. For all the firms using the same system of property rights, some pieces of legislation and the skills, necessary to its application and enforcement, are common inputs produced and used under a system of pronounced economies to scale. A piece of legislation can be used an infinite number of times without being destroyed. The same type of legal expertise by the same law firms can be used, enjoying the advantages of increasing returns by all the firms using the same property rights system. The enforcement of contracts by courts of law is very likely to be more predictable and precise for the firms using the most widespread property rights system. Finally, customary law requires that a custom be well established and this is more likely to happen within the framework of the property right system used by the majority of firms.

The complementarity between technology and property rights that is encompassed by the concept of organizational equilibria implies that network externalities can act indirectly on property rights via technology and also indirectly on technology via property rights. Network externalities among firms' technologies may also imply the homogenization of property rights. Vice versa, network externalities among the ownership systems of different firms may also imply the standardization of technologies. When these complementarities between technological and property rights standards exist, the speciation of few alternative organizational models may become very difficult in situations where the competition of the old species of organizational equilibria is very strong.

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[8] See Arthur (1989).

The two-way-causation flowing between technology and property rights implies that institutional shocks, such as occurred during the American occupation in Japan, may have lasting consequences on economic systems Moreover the complementarity between rights and technology at both intra-firm and inter-firm levels imply that a strong competitive pressure may stabilize rather than upset inefficient "organizational species". Thus, at least in principle, we should not be surprised if the speciation of new successful species of organization could occur as a result of a political decision in an environment relatively protected by the pressure of competitive forces while the creative activity of competitive markets could lag behind this organizational innovation.

The separation between ownership and control. If control could be achieved through ownership alone the "second best" solution invoked by the New Institutional framework would be achieved only insofar as skills, as previously defined, and wealth happened to be allocated in the same way among individuals. While such coincidence might indeed occur, especially as the result of both skills and wealth being transferred from one generation to the next in closed family groups, it will certainly not be the rule. Arrangements have then emerged in all developed societies whereby ownership of financial resources is partly or fully substituted as a means to exert control and entrepreneurs can collect debt capital or raise share and still retain control. It can indeed be argued that it is only thanks to such arrangements and to the separation between ownership and control that they have allowed that economic development has achieved the extraordinary results seen in this century.

To allow separation, a fundamental conflict of interest has to be somehow resolved between investors - banks or shareholders - and entrepreneurs holding control. Devices must exist which protect investors from their failure to finance the right entrepreneur and from abuses of power control: abuses might include the entrepreneur's enhancing his own non-monetary benefits which cannot be appropriated by investors, his acting in the interest of other concerns that he directly owns, or his embezzling of funds. In a world of incomplete contracts these problems cannot be addressed by writing contracts where all wrongful doing is ruled out. In the same way, since investors must not prevent marginal deviation of entrepreneurs' behaviour from good practice but must prevent major diversion of funds, mechanisms making entrepreneurs' income in some way linked to the market value of the funds they manage can have only very limited effects[9]. Investors must then be granted the power to monitor control. But, whatever the monitoring devices are, since the incompleteness of information will make signals of mistakes and abuses very noisy, monitored entrepreneurs can be punished (and lose control) when no mistakes or abuses have been committed. Alternatively, they may remain uncensored when interference would have been justified.

9 See Hart (1995)

A trade-off thus arises between certainty of control and the protection of investors. The harder it is for investors to interfere with control, the more deterred they are from financing and the more difficult it is to ensure that an efficient allocation of control is made. On the other hand, the easier it is to interfere with control, the less effective control is as a means to enhance investments and innovation by entrepreneurs: they will no longer be guaranteed unconditional use of company's assets and reduce their irreversible investments in human capital which depend on that use. A further, "multiplicative negative effect" may be produced by high interference through the behaviour of lower rank managers: the more likely it is that investors' monitoring implies hostile changes of control, the more uncertain managers will about their prospects of climbing the firm's ladder through the working of the "internal market" which in turn will lead them to underinvest.

The many alternative institutions, which have developed to address the trade off we have now illustrated, can be grouped in the following six categories:

a) inside monitoring through membership of the board or other corporate organs (this may be exercised directly by the non-controlling owners, or delegated to outsiders or to financial institutions with holdings in the firms);
b) *ex post* outside monitoring by courts of law through shareholders' law suits in order to obtain redress for breach of trust by entrepreneurs (or by the board which should monitor them);
c) market, or the threat of exit, such as the chance for non-controlling shareholders to transfer ownership and control to third parties, even without the entrepreneur's consent, if the former feel that the latter has misused or abused his/her powers;
d) monitoring through the political market, by nationalising firms and entrusting supervisory power to parliamentary or governmental bodies;
e) relations of trust between entrepreneur and owners that ensure the former's cooperation with the latter.
f) contractual means such as pacts among shareholders, statutory provisos and pyramidal groups - whereby the voting rights of non-controlling shareholders are spread out over a large number of firms while those of the entrepreneur are concentrated in the company at the top of the pyramid - which, while not providing any monitoring tools to investors, offers some shareholders a way to enforce control.

Two rather distinct roles can be played by inter-firm share-holdings. In the case of pyramidal groups, ownership links, by dispersing non-controlling shareholders' voting rights, allow the controlling shareholder to expand the allocation of control well beyond his/her personal means. In Italy, where this system has been exploited most, for the average of existing pyramidal groups with at least one listed company and controlled by one shareholder or a set of family shareholders, entrepreneur's share capital is about 12-13 per cent of total group's capital (about 5 per cent for Fiat). Alternatively, inter-firm shareholding, when it does not amount to the control of one firm on another, not only provides a link among firms for strategic interaction, it may also help to consolidate managers' control: very intense cross-shareholdings among firms, either directly, or through "intermediate firms", can in fact allow managers with no or little shares to disperse shares and to sustain each other. This is the case of Japan, but an example of this system is also provided in the U.S. system by private pension funds of two firms investing in each other shares.

The prevailing of any one of these several corporate governance devices will affect directly the allocation of control by making more or less binding the existing allocation of wealth. It also affects the ways in which transfers of control take place and the multiplicative effect on the incentive to invest of all managers. Let's consider the three cases when monitoring relies on exit or courts of law - b, c - is exercised "internally" by a financial institution - a - or is entrusted to family relations. In the first case, the market for managers is mostly an outsiders market, internal career is highly risky and long-term commitment is discouraged, but higher chances exist for newcomers to step in. In the second case, the reverse occurs: internal managers can rely on the firm's leading financial institution to preside over changes of control and make sure that the best managers get selected. More controversial is the third case: the internal market can be effective, but the career prospects of managers can easily be endangered by conflicting interests of the heirs.

The corporate governance systems prevailing at a given time in history in any each country can be interpreted as a combination of the different existing devices. In understanding why a particular mix prevails in a country at a given time one should very much rely on the self-reinforcing mechanisms that explain multiplicity of organizational equilibria. Once a corporate governance system prevails, the successful speciation of a new device is prevented by the high risks and costs that any individual entrepreneur runs in presenting investor with a new institutional "package" and that any individual investor runs in accepting it. The existence of very strong network externalities makes it extremely expensive for any group of investors or entrepreneurs to experiment with new, privately developed legal devices. The compulsory change of existing ownership structure or the reform of corporate law, stock market regulation or bank-industry relation, whether due to endogenously developed social changes or to exogenous military rule, can then bring about deep and possibly irreversible changes in the way control allocation is transferred.

4. Organizational Equilibria and Species of Capitalism.

The self-reinforcing characteristics of organizational equilibria may explain some puzzling features of the dynamics of capitalism: coexistence of different "national" forms that occurs in spite of common technological innovations, such as those associated with information technology, and the fact that "new organizational species", whose success is often related to these new technological opportunities, tend often to emerge in countries that are different from those that were successful in the preceding phase of capitalist development[10].

Chandler (1990) pointed out how the managerial revolution (that was also to lead also to the development of Taylor's "scientific management") was paradoxically inhibited in England by its prominence in the first industrial revolution.

In the first industrial revolution, where textiles allowed successful small-scale production, family controlled firms were adequate. In this framework, while family members had an incentive to make firm-specific investments and could also, without serious organizational costs, become difficult-to-monitor factors, the same was not true for non-family-member managers. These managers were trapped in an "organizational equilibrium" that was a vicious circle for them: because of the family system, weak managerial rights implied an unfavourable distribution of asymmetric information and of specific skills which, in turn, implied that the case for managerial rights remained very weak. In England this "organizational equilibrium" resisted the pressure of the "second industrial revolution" where the changes connected to development of the railways pushed toward the direction of the development of sophisticated managerial hierarchies. Thus, the self-reinforcing aspects of "organizational equilibria" can explain why the "new species" of managerial capitalism, together with the full strength of the second industrial revolution, blossomed with much greater intensity in the U.S. and Germany than in Britain. Still, the new species of capitalism co-existed with the original species and no country was purely characterized by a single organizational form.

Under "managerial capitalism", often independently of their ownership entitlements, managers acquired considerable rights in the organization and accumulated great amounts of hidden information and specific skills. By contrast, the development of "scientific management" implied that the large majority of workers were "expropriated" of the hidden information and of all the specific skills that had survived the first industrial revolution. Workers' weak rights in the organization were connected to an unfavourable distribution of asymmetric information and specific skills causing the self-sustaining organizational equilibrium that characterized Taylorism.

Also in the case of the "Tayloristic organizational equilibrium", one of the major challenges to its vicious circle failed to occur at the centre of the system in the U. S. where the competition among the numerous members of the "Tayloristic" species was strongest. By contrast, it came about in defeated post-war Japan contributing in an impressive way to the

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[10] In other words the evolution of capitalism seems to be characterized by forms of "allopatric speciation" in the sense that new forms of capitalism tend often to emerge in countries different from those where the preceding forms had had a successful development. Pagano (2001a and 2001b) considers the problems related to the origin of new species in biology and some common law of structure and change that characterize the formation of new organizational species; in particular, the emergence of American and German managerial forms of capitalism are considered in the framework of the theories of "allopatric speciation" developed in evolutionary biology.

exceptional development of its economy that, for a while, almost challenged the supremacy of American capitalism[11].

Besides its peripheral location, the new species did not emerge "spontaneously" as the exclusive outcome of the workings of market forces. By contrast, the strong "institutional shocks", that characterized the years of the military defeat and the American occupation of Japan, had a fundamental, and very often unintended role, in the complex arising of the new organizational equilibrium. While a comparison with American capitalism can be easily used to emphasise the numerous elements of continuity within the history of Japanese capitalism, the discontinuity between the *zaibatsu* and the *keiretsu* system is, indeed, striking[12] and cannot convincingly be explained without referring to the institutional shocks that characterized that period.

The American expropriation of the zaibatsu families and the compulsory retirement of senior managers were coupled with an initial period of strong unions rights. These factors quickened the birth of a new organizational equilibrium where the workers acquired strong rights in their organization. These rights favoured the accumulation of job specific and difficult to monitor skills[13], which, in turn, reinforced the rights of the workers. In other words, the institutional shocks created the conditions for a new self-sustaining organizational equilibrium (Pagano, 2001a) characterized by a distribution of asymmetric information and of specificity characteristics that was in sharp contrast with the theory and practice of Taylorism.

Similar self-reinforcing mechanisms characterize other modes of production such as Italian districts, "German Corporatism"[14] and the enormous varieties of organizational forms that are emerging in the ex-socialist countries[15]. As in the case of the second industrial

[11] Another challenge came from West Germany and its system of "unionised" capitalism based on occupational markets. In this case employers' associations and the trade unions with the help of the State used to agree on a common division of labour within each firm that allows the creation of "flexible" occupational markets characterized by the fact workers can move from one firm to another without wasting much organizational specific knowledge. Observe how this flexibility is strictly associated to the internal rigidity of the firms that must be characterized by a common type of division of labour and related professional competencies. On these issues see Pagano (1991a, 1991b) and (1993).

[12] The discontinuity between pre-war and post-war Japan capitalism and the relevance of the post-war institutional shocks can be clearly understood by considering an alternative (an perhaps more appropriate) comparison with Italian capitalism. While the policies of the Allied Powers reinforced the Italian system of family capitalism, the American occupation terminated its Japanese version. The "institutional bifurcation" that was created had long lasting consequences and shaped the development of the two countries (Barca, Iwai, Pagano and Trento 1999).

[13] In particular team work, that often replaced the assembly line in Japanese organizations, was necessarily characterised by the specificity of the skills (each skill becoming specific to those of the other team members) and by the difficulty to monitor the workers (it is difficult for an outsider to disentangle the contribution of a single worker from those of the other members of the team).

[14] In many respects the Japanese species of capitalism represented a "mixture" of rigidities and flexibility opposite to those of the German system. In the German system the rigidity of the internal division of labour allows the external flexibility of occupational markets; by contrast, in the case of the Japanese system, the flexibility of the internal organization of the firm implies that often no equivalent "slots" for the skills of its workers could be found in other organizations. In this sense the "internal flexibility" of Japanese firms is somehow associated to their "external rigidity". Thus, given the two different associated technologies, the German system could be regarded as a system of self-sustaining "occupational rights" and the Japanese could be regarded as a system of "self-sustaining organizational rights" (Pagano, 2000).

[15] This multiplicity of feasible organizations is very important for economic policy and, in particular, for the problems related to the transformation of the former socialist countries (Aoki 1995, Pagano 2000). A

revolution the "third industrial revolution" (based on ICT) will have a great impact on the reassessment of the relative merits of these organizational forms and some may not turn out to be viable. However, also in this case the diversity of organizational forms is unlikely to be reduced. While we have seen that the influence of informational technology has yet to bring about unidirectional transformations, pre-existing property rights will somehow continue to shape (also information) technology.

One possible argument, which foresees a reduction in the "biodiversity" of capitalism, could be based on the observation that information technology favours the process of globalisation of the world economy and that, in a "globalised world", imitation and other factors may bring about an increase of organizational homogenization. However, in a globalised world the different existing forms of national capitalism's may more effectively exploit their "comparative institutional advantage" in different sectors of the economy and some new viable forms of capitalism may even emerge in this process. In this sense, globalisation allows the specialisation of the economies in those sectors where they have or develop a "comparative institutional advantage" related to their own particular organizational equilibrium and may even favour the diversity of the forms of capitalism. Thus, there is no reason to believe that the "biodiversity" of capitalism is bound to decrease. By contrast, at least in this particular sense, we are far from reaching an "end of history"[16].

It is within this context of persisting diversity of organizational forms that we may seek to understand why Chandler's managerial revolution never took place in Italy and why family capitalism has persisted as the main organizational form for large corporations.

5. Changes of Italian corporate governance between the two world wars.

Italy is a typical latecomer, industrialising only at the end of the nineteenth century, but the process remained fragile for decades and was not put on truly solid foundations until after the World War II.

The country was traditionally marked by a shortage of capital (absence of primitive accumulation), scarcity of raw materials and the lack of a large market (due to its historical division into small, independent states)[17]. The model of development that emerged in the closing decades of the nineteenth century was centred on heavy industries, sustained by

comparative institutional analysis is required to consider the self-reinforcing mechanisms or the complementarities (Aoki 1996, 2001) that characterize each one of the feasible alternatives.

[16] Other reasons for which this is a very unlikely outcome are given in Hodgson (1999) who points out how the idea of the "end of history" is "deeply connected to an Enlightenment principle. This is the idea of a universal history: the notion of an universal destination, underpinned by absolute rational principles." (Hodgson 1999 p 153)

[17] In the words of a great Italian thinker of this century**,** Antonio Gramsci : “the Italian economy was very weak (and) there was no large and powerful economic bourgeoisie; instead there was a great number of intellectuals and petty bourgeois, etc. The problem was not so much to free already developed economic forces from antiquated legal and political fetters as to bring into being the general conditions for these economic forces to arise and develop along the same lines as in other countries”, Gramsci, (1975a), p. 57.

public procurement and protected by high tariff barriers[18]. Moreover, Italy lacked a "specific industrialization ideology"[19] - be it the French myth of the firm or the ideal of building a new society as the in Soviet Union, in order to forge a mass consensus for the drive toward industrialisation.

In the absence of these factors, during the first phase of industrialisation beginning in 1895, the substitutes were the "mixed banks", some founded with German capital (e.g. Banca Commerciale Italiana and Credito Italiano). These financial institutions operated through a *mix* of credit relations and equity subscription. In the framework proposed by Gerschenkron, in Italy the mixed bank acted at first as a *substitute agent* to overcome the scanty primitive accumulation of capital, and later as the channel by which diffuse, fragmented savings, which the holders had no intention of putting into illiquid form, could be funnelled into equity that would have had a great deal of difficulty finding buyers in the stock exchange[20].

It was during the 1920's that this "bank-based corporate governance" degenerated due to a progressive erasure of the separation of interests between banks and large industrial corporations, combined with the weakness of the "rear echelons", i.e. the lack of a credible reserve of small and medium-sized businesses. In addition to sustaining growth, then, the large banks also acted as coordinators, seeing to the placement of new share issues (often enough, with the usual small circle of customers)[21]. Corporate crises were regularly dealt with and resolved by the banks themselves. If a crisis was too large to be handled by a single bank, a rescue consortium of very large dimensions would be formed[22].

The natural corollary to the prevalence of debt capital was the failure of the stock market to take off[23]. After the turn of the century it was the mixed banks themselves that sponsored the development of the stock market, with a view to making their equity shares more liquid and more easily disposable.

With an inadequate stock market and stable, non-competitive relations between banks and industry, between 1900 and 1913 the groundwork was laid for an intensive concentration of control and the formation of "corporate pyramidal groups, based on family

[18] As Gerschenkron noted, and as has been confirmed by more recent studies (Federico and Toniolo, 1991), protectionism was misdirected, favouring wheat production and basic industries with strong lobbying powers but poor long-term prospects.

[19] See Gerschenkron, (1962), p. 11.

[20] This thesis has not been dismantled even by subsequent studies emphasising the limits of the "German-type bank" experience. See Confalonieri, (1974).

[21] On the eve of World War I, both Banca Commerciale Italiana and Credito Italiano had significant equity stakes in a number of major nascent enterprises.

[22] See Zamagni, (1990).

[23] Until the reform of 1913 the primary source of law governing Italian stock exchanges was the French commercial code promulgated by Napoleon in 1807. The stock exchange, conceived of as the centre for directing savings into industrial and commercial activities, was a Napoleonic concept, introduced when Italy was in the French sphere of influence in the first decade of the nineteenth century. Bourses were founded in a number of Italian cities between 1802 and 1808, but this forcible innovation, not borne of any commercial necessity, was greeted with indifference if not outright hostility. The Italian exchanges were not structured as free associations of participants, on the English model, but were imposed from above, on the state-controlled pattern of the "Bourse du Roi". See Aleotti, (1990), p. 29.

control". However, it was only after the enormous profits deriving from military production (in steel, shipbuilding, mechanical engineering and chemicals), during WWI, that the relationship between banks and enterprises degenerated irretrievably; the main Italian banks acquired significant equity stakes in many industrial sectors and so from a "German-style" they moved toward a "Japanese-style" of banking. Public procurement orders and massive profits restored corporate finances to health and powerfully spurred further concentration, especially by mergers and buyouts. In these years, the power relations between banks and industrial corporations were inverted, and industrial pyramidal groups now made take-over bids for the leading banks, although unsuccessfully.

The stock market crash of 1929 thus hit the Italian financial system in a moment of pronounced industrial and financial concentration. The intermingling of credit and industrial capital and the underdevelopment of the stock market, but above all the creation of corporate groups based on cross-shareholding, made the crisis particularly acute, hindering adjustment and creating a domino effect. The tight monetary policy and the decision to defend the external value of the Italian lira contributed to amplify the destructive nature of the shock in Italy. The crisis struck huge industrial-banking colossi, and the organization into pyramidal groups amplified the repercussions of the plunge in share prices. The leading banks found it simply impossible to liquidate their assets, which consisted primarily in equity holdings in the crisis-torn industrial groups. This paved the way for the most sweeping reallocation of ownership in the history of Italy, and above all "for the State to assume the central function within Italian capitalism" which it had refused at the turn of the century. State ownership became a new device to ensure full separation between ownership and control and to enable a group of talented managers to acquire control over industrial and service firms.

The government decided to refinance the troubled banks by buying out their industrial holdings and transferring them to a new agency created especially for this purpose in 1933: the Institute for Industrial Reconstruction (IRI, Istituto per la Ricostruzione Industriale). Constituted as a holding company and as a corporation under private law, IRI took over the entire equity capital of the mixed banks, hence more than 21 per cent of all the equity capital of limited companies existing in Italy at the time[24].

Meanwhile, industrial concentration had increased notably, and in 1936 fewer than 1 per cent of all Italian limited companies accounted for half the total share capital[25].

The creation of IRI was accompanied by the fundamental Banking Law of 1936, which prohibited banks from holding equity participations in industrial companies and

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[24] 100 per cent of Italy's defence-related steel industry and coal mining, 90 per cent of its shipbuilding, 80 per cent of maritime shipping, 80 per cent of locomotive manufacture, 40 per cent of the non-military steel industry, 30 per cent of electricity generation, 20 per cent of the output of rayon and 13 per cent of the output of cotton. In addition, IRI owned a number of mechanical engineering firms, controlled the three largest commercial banks and the telephone service in central and northern Italy, and possessed very extensive real estate holdings. See Castronovo, (1995).

[25] See Aleotti, (1990).

required maturity specialisation in their credit business, assigning short-term credit business to ordinary banks and medium and long-term credit to special credit institutions. Thus the German-style mixed bank vanished from the scene. But the Italian solution, unlike the American case[26], was not intended to relaunch the stock market as a means of attaining a broader ownership base and more diffuse corporate control; the dominant logic continued to view the banks as the linchpin of industrial finance.

IRI, on May 6, 1937, was transformed into a permanent institution. The decision not to reprivatise the companies acquired was due in part to the fascist regime's desire to use public corporations as an instrument of industrial policy, but primarily it was due to the difficulty of finding private buyers for so many public firms[27].

For the Italian economy, the crisis of the 1930’s thus represents a truly structural divide, with an outright transformation of the model of corporate governance occurring between 1930 and 1936. With the direct, massive intervention of the State, Italy moved from an ownership pattern based on the corporate family group and mixed banks (similar in some ways to the German model) to one centred on the corporate group but subdivided into state owned and private groups controlled by families. A characteristic feature of the Anglo-American model of corporate control was introduced, namely separation of banking and industry. The bank as controller, mandated to oversee the rehabilitation and restructuring of firms in crisis, disappeared. The resulting vacuum was partly filled by the state holding company, which was repeatedly required to take over companies in financial distress. Due to the lack of other institutions that could have taken over the role played previously by the mixed banks, the state provided relevant resources and direct ownership over an important section of the Italian economy.

6. Italian corporate governance in the post-war period

The Italian model of corporate governance after the restructuring of 1933-36 was based on two major actors: family-controlled pyramidal groups and State-owned pyramidal groups. The end of the war and the liberation of the nation from fascism by the Allied forces and by Italian partisan units, the end of the monarchy and the institution of a republic, the drafting of the democratic Constitution and the formation of a coalition government involving all the anti-fascist forces did little to alter the institutional structure of Italian capitalism. Most of the negative aspects of the Italian corporate governance were perceived by the Economic Committee of the Constitutional Assembly, but no reforms were implemented.[28]

From 1943 till December 1947 the Anglo-American armies were a powerful actor on the Italian political scene. The British Prime Minister, Churchill, since 1943 was

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[26] This was quite different from the path followed in the United States, where financial rehabilitation and the separation between banking and industry were founded upon the recovery of the stock market, with the formation of the SEC, the regulation of mutual funds and deposit protection legislation.

[27] See Cianci, (1977).

[28] See Barca, (1994), chapter VIII.

preoccupied had been preoccupied with the defence and re-establishment the “traditional ownership relationships in Italy”. Churchill had been an admirer of Mussolini in the 1920’s and still during the last years of the war believed that the key issue in Italy was to avoid a communist take-over[29]. In 1944 a civil war broke out in Greece between the communists and the monarchists and the British troupes were sent to fight against the “reds”; this reinforced the conservative approach within the Allied. Churchill was not at all interested in purging Italy of the fascist presence in the State, the economic life and society at large, and considered the monarchy as the preferred institutional solution for the future Italian State. A military defeat of the fascist regime was enough in his view. For several months, the British government vetoed the first American recovery plans in support of the Italian industries[30].

The American point of view was quite different. The Americans refused to recognise the King as the only legitimate representative of the new Italy and rapidly established relations with the Partisan forces organized in the National Liberation Committee (CLN); and unilaterally, from September 1944, decided to distribute food and financial aid. In general, however, the Allied occupation forces tried to speed up the process of reconstruction, with the explicit goal of preventing social disorder along with any possible left-wing insurrection. At the end of 1944, the CLN signed an agreement with the American general H.M. Wilson in Rome receiving some assistance in the struggle against the nazi-fascists in Northern Italy but agreeing to dismantle their military organization as soon as the war was over and to be considered not as a real government but just as a military group[31]. For almost two years Italy was divided into two separate States: a monarchy in the South, under the Allied protection, and a residual fascist regime in the North, under German control. The bureaucracy of the Southern government was a legacy of the previous fascist regime. Even after the re-unification of the country the state apparatus was almost totally based on the fascist structure. The promised purges were never happened and a general amnesty (June 1946), for fascist crimes was passed by the new government[32].

The invasion by the Anglo-American forces certainly enhanced a liberal rule in Italy. On the other hand, following the armed defence of the factories against the German invaders in several firms in Northern Italy, workers had their first experience of participatory councils, fiercely opposed by the entrepreneurs. The necessity of accelerating the process of reconstruction and the emergence of a new conflict - the Cold War with the Soviet Union - induced, however, the Allies to support a quick return to the traditional system. Two other factors moved in the same direction: (1) the view of the leading party now emerging from the Resistance, the Communist Party, which held that existing institutions should at first be

[29] See Ginsborg, (1990).

[30] See Ellwood, (1985).

[31] Sandro Pertini, future Italian President of the Republic, denounced this agreement as “the total surrender of the Italian Resistance movement to the English interests”, see Ginsborg, (1990).

[32] The judiciary was not touched by the purge, so that the total majority of the purging trials held in the early months after the war came out with" not guilty” sentences. Still in 1960, 62 of the 64 local government officers (Prefetti), all of the 135 Police chiefs (Questori) were appointed under the fascist regime Ginsborg, (1990), p. 120.

retained in order to allow rapid Reconstruction and (2) the positions - and the preferential links with the Americans - held by a small group of managers who had emerged in the State-owned companies and now leading them[33].

As a result of these several factors, State-owned companies were not dismantled, the family corporate groups were not reformed, and no major reform was devised. After a very short phase of coalition government which included the Communist Party, in 1947, in view of the promises of American financial help through the "Marshall Plan", the Christian Democratic leader Alcide De Gasperi formed the first government excluding the left-wing parties (socialists and communists). Italy clearly went under the American influence: it signed the Bretton Woods agreements (1947), received financial transfers under the European Recovery Program [34] (1948), and joined the NATO military alliance (1949). From May 1947 till February 1962, Italy was ruled by a series of governments firmly centred on the Christian Democrats and liberal parties. During this "liberal" phase, however, little was done in terms of traditionally liberal reforms: no antitrust laws, no reform of the commercial code and no steps toward a more developed financial market.

In the absence of financial institutions exercising, interim and *ex post* monitoring through equity or debt relations with the firms, all large firms, organized as hierarchical groups, were kept under family control or under the State control. The return to democracy with the rise of a new governing class who had been formed largely in the opposition to fascism and the decisive option for European integration and for free trade permitted, however, the full development of the potential inherent in the model of corporate governance established between 1933 and 1936.

Furthermore, it can be argued that in the first 10 to 15 years after the end of the war some features of the governance framework, in the contingent economic and cultural context, were suited to very rapid development. State control gave a new generation of managers, mostly untainted by involvement with the previous fascist regime (and in some case, known opponents of it), the chance to acquire control of large, emerging enterprises: a sense of mission linked to the post-war reconstruction climate helped to make up for the monitoring failures of the model, while many of the relevant strategic choices were clear-cut (providing the country with an adequate and stable supply of energy, developing and modernising the steel industry to suit the needs of the engineering sector, building a highway system, etc.). At the same time, low wages due to an excess supply of labour allowed rapid growth in small and large family-controlled firms to be fuelled by abnormally high self-financing.

Some groups (liberals and Communists, though for different reasons), maintained, after the war, that these public enterprises should be eliminated as a holdover from the fascist regime; according to others, the persistent backwardness of the economy made the

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[33] Barca and Trento (1997).

[34] Between 1948 and 1952 Italy received transfers of a total value of US$ 1,470 million, equivalent to 11% of the total ERP aid to Western Europe. See Romeo (1991), p.174.

privatisation of an enormous group like IRI simply impracticable. The representatives of the US government had also questioned the wisdom of retaining a public group created under fascism. In July 1944 Donato Menichella, one of the creators of IRI back in 1933, had addressed a report to Captain Andrew Kamark, the representative for IRI of the Finance Sub-Commission of the Allied Control Commission. Menichella had argued that the public ownership of banks and industries did not reflect the fascist regime's bent for planning but had stemmed from the rescue of the banks, whose purpose was primarily to protect savers and depositors and safeguard the stability of the banking system as a whole[35]. The impossibility of finding hands capable of running IRI’s banks and industrial firms through private ownership, Menichella maintained, had compelled the government to transform IRI into a permanent structure[36].

Over and above this historical judgement, the position that won the day (also for the Allied forces), in the late forties, was that public enterprises were good tool for speeding up reconstruction[37]. State-owned enterprises were finally considered as a powerful tool to ensure a proper separation between ownership and control, probably one of the few tools available in a rapidly developing country without a real financial market. The structure of corporate governance in the state-owned industrial sector became one in which management exercises the power of control (i.e., of strategic design). The arrangement differed from the theory in that during this initial phase the supervision exercised by the political power structure was not stringent.

State-ownership enabled, in Italy, a separation between ownership and control that was limited in the private sector. A new generation of public managers was empowered with the control of state enterprises. In the post war period, this entrepreneurial fluidity in the state-owned sector contrasted with the immobility in the large private firms. In the state-owned pyramidal groups the “residual right of control” seems to have been firmly in the hands of management. Management (and not the political tutors) chose to focus the accumulation effort on rebuilding a modern industrial apparatus in steel, shipbuilding and engineering, and on major infrastructure (highways, the telephone network, etc.).[38] This institutional solution was all the more necessary given that in the absence of other models of corporate governance the only alternative source of finance for such a project would have

[35] He offered a severe judgment of Italian financiers as a group: “Italy has never had a class of financiers who loved banking for banking's sake; that is, who were disposed to invest their money in bank shares and to operate banks with the sole aim of earning the largest possible dividends from those shares. Only industrial groups have manifested any interest, at various times, in acquiring stakes in the leading banks”, Menichella,(1944), pp. 127-128.

[36] This position belongs to a long-standing line of thought according to which Italian capitalism had always been fragile, bereft of legitimacy in the country and lack a farsighted bourgeoisie. See Gramsci, (1975b), p.56.

[37] See Bottiglieri, (1984).

[38] In particular, at the turn of the decade, Oscar Sinigaglia, head of the steel division, drafted and implemented a plan for the construction of three full-cycle steel plants comparable in size and technology to the most up-to-date foreign facilities. Until then the Italian steel industry had been modest and antiquated, mainly reprocessing scrap metal. Sinigaglia argued that without a modern steel industry Italy would never have a true engineering or motor vehicle industry. See La Bella, (1983), p. 53.

been bank credit; and the leading banks (Banca Commerciale and Credito Italiano) were closely connected to the interests of just a few large Italian and foreign industrial groups[39].

What explains the satisfactorily performance of the state-owned groups in these early years of the new Italian democracy? Three elements were present from 1945 till the end of the 1950's: public managers were assigned to pursue relatively simple targets: reconstruct the economy and foster growth, build the basic transport and energy infrastructure and set the engineering sector on the solid ground of home steel production; public management shared common experiences and a sense of mission often built through opposition to fascism; the ruling centre-right parties were strongly competing with left parties to prove that capitalism was capable of bringing about fast development[40].

All three conditions disappeared at the end of the 1950's. The market for political control failed: from 1945 to 1993 the government was uninterruptedly controlled by a series of alliances among an unchanging group of parties, the communist party was relegated to an often sterile opposition and failed to function as watchdog over the public enterprises. Indeed there was often collusion between majority and opposition in this regard (for instance, most of the measures on behalf of the public enterprises, including subsidies, were approved unanimously in Parliament)[41].

An attempt to introduce some monitoring devices in the management of the State-owned system was made in 1956 in the creating of the Ministry for State Shareholding designed to exercise political supervision of the IRI and the ENI groups. At the same time, multiple strategic goals were imposed on the state-owned enterprises: to contest monopoly, to promote new industrial relations, to sustain employment and to foster the economic development of the South. By adding new goals to the original one it became very difficult for the Ministry for State Shareholding to perform monitoring activities. So-called "social objectives" could always be cited for as an excuse for poor results obtained by public managers.

The development in the governance of large private corporations paralleled that of State-owned companies. The issue of reforming the corporate governance structure of Italian industry was indeed at the centre of the economic and political debate in the first two years after the war, in particular in the Constitutional Assembly, but no reform was enacted. Available data on major Italian private corporations shows that the pyramidal groups structure was indeed already used in 1947 but that it did not often allow for a great degree of separation between ownership and control (table 1). Together with the likely expansion of such leverage and with the use of contractual tools (such as proxy votes entrusted to directors, multiple-votes share, etc.) the financing of the rapid post-war growth of large private corporations was then provided by extraordinarily high profits and self-financing. This in turn occurred thanks to a rise of real wages that were much lower than productivity

39 See Colitti, (1979), p. 117 ff.
40 See Barca and Trento, (1997).
41 See Maraffi, (1990).

due to very uneven labour relations, weak Unions, high unemployment (in European-wide comparison).

This abnormal state of affairs slowly terminated at the end of the 1950's, in the same years when State-owned companies were undergoing major changes. After 1958 tensions arose in the labour market and wages rose very quickly. By 1962-63 the share of self-financing had drastically dropped. After a brief period of truce, tensions quickly resumed keeping profits relatively low till the early 1980's. A growing need arose then for external capital and that, in turn, underlined the failures of the Italian corporate governance. It was not enough for relevant reforms to be enacted: some partial changes took place only in 1974 after long controversies. Pressure grew then for a much more intense use of pyramidal groups and new contractual means were introduced such as shareholders voting agreements. A growing role came to be played by Mediobanca, a merchant bank founded in 1946[42], which, by devising financial plans and holding strategic shares in private companies frequently allowed founding families to maintain their control over them.

The intense recourse to pyramidal groups, as a means to separate ownership and control, is illustrated in table 2 where data for three major corporations, Fiat, Pirelli and Falck, in year 1993 are reported. Recent research on the current ownership structure of Italian industry shows that in 1993 the average degree of leverage in Italy was about 8 for private non-banking holders of control[43].

The very relevant increase in groups' leverage has been achieved by lengthening the group structure and by diluting the capital held by the family or by companies in the higher ranks of the group. This dilution has undoubtedly led to a relevant weakening of the group structure: in other words, family control is no longer unchecked, especially in those companies of the group which, by being closer to the core business, are clearly preferred by external shareholders. Let's consider Table 2 where a comparison is presented for Fiat, Falck and Pirelli of the major shareholders of the "key companies" of the groups in 1947 and 1993. In 1947 only the Pirelli family no longer the majority of votes in the key company Pirelli Spa: control was then exerted through the support of a set of well-established households, mostly from the same town (Milan) and sharing the same cultural roots. In 1993, the founding families still controlled an extraordinary high number of shares of all those key companies, partly thanks to groups' branches above those companies (as in Fiat) but this was certainly not enough to exert stable control.

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[42] The 1936 reform had produced a banking system in which commercial banks were prohibited from medium and long-term lending. In 1944 and 1945 Raffaele Mattioli, chairman of Banca Commerciale Italiana, sponsored the formation of a new industrial credit institute mandated to offer five-year credit to firms. Originally, the plan called for close links between the new institute and Banca Commerciale, virtually replicating the "universal bank", with Banca Commerciale specializing in ordinary credit and the new institution financing longer-term industrial investment projects. Eventually, in 1946, this project led to the creation of a new medium-term credit institution, Mediobanca, whose equity capital was mostly subscribed by three IRI banks: Banca Commerciale, Credito Italiano and Banco di Roma. Originally intended in part to sustain the development of small firms, over the years Mediobanca was transformed into a true investment bank for Italy's leading private enterprises.

[43] See Barca, (1995) and Barca, Bianchi, Brioschi *et al.*, (1994).

A new ownership structure has then arisen in these companies made of founding families, banks and insurance companies and industrial firms. The latter do indeed play a role in Pirelli and Falck through cross-shareholdings, which are similar to the Japanese case. In Fiat the supporting role is played only by banks and insurance companies, both through the holding of shares and through the threat of acting as “white knights” in case of takeovers. In such company a tripolar equilibrium has probably through which control is exerted through some agreement or compromise between the founding family, the top manager and the leading financial institution (namely Mediobanca). A similar arrangement arose in A.F.L. Falck in 1996. The instability of such arrangements might well explain the resilience of founding families in expanding their corporations, as the technological and competitive challenges require. It might also explain the strong pressure that arose to finally devise a reform of Italian corporate governance.

Some of same factors, which have brought large corporations to crises since the 1960s, have also unleashed small-scale, local entrepreneurial energies.

In many areas of Central and Northern Italy and also in a few provinces in the South, so called “potential industrial district” were already in evidence since the 1950’s (see Brusco and Paba, 1997): technological knowledge and human capital had been accumulated and were ready to migrate from large firms to new more flexible small scale activities. Informal financing channels (family savings, etc.) and the provision of large State subsidies had been sustaining the survival and growth of small firms. Furthermore in Central and Northern Italy, locally based civic culture was thriving and ready to fuel micro-industry development. However, only at the beginning of the 1960’s, when a "social shock" came from the crisis of the governance of large corporations, “potential districts” quickly developed into fully-fledged districts: because of the "institutional shock" large companies tried to encourage skilled workers to set up their own firms which, because of their small size, could be isolated from the social conflicts impairing productivity in the large corporations.

This lucky for the Italian economy occurred when the world was facing the consequences of the " shocks" related to the advent to information technology and programmable machines. These "technological" shocks made "small size" firms based on "flexible specialisation" very competitive in world markets. The fast growth of the Italian small firm sector created the conditions under which many individuals could enjoy the rights related to ownership of their firms. These individuals had the incentives to develop the specific skills that were necessary for their development and, having developed these skills, often became the most efficient possible owners. The institutional shock of the 1960 's had an important role in bringing about the virtuous circle characterizing this self-reinforcing organizational equilibrium. While new technological changes made it possible for large sectors of the economy to be based on small size firms (linked however by various forms of untraditional cooperation), Italy was one of the few countries to exploit this opportunity to such a great extent. While (or, perhaps, because!) the organization of governance in the large firms was stuck in a form a family capitalism characterized by social immobility and class conflicts, the governance system characterizing small firms became a "model" to be studied and imitated in other parts of the world. Italy, which had gone through major institutional shocks in the thirties and, unlike Japan, had missed the opportunities offered by the post-war institutional shocks, could, in some respects, paradoxically benefit from the social shocks of sixties. However such benefits could only postpone the need for a substantial reform of the corporate sector of Italian Capitalism.

7. The nineties: a decade of change…and continuity

The nineties can be considered a decade of deep change for Italy. The entire political system born after WWII came to an end. Labour and financial markets were also hit by reforms.

In the last decade, new laws have been passed concerning banking and financial sectors, a large program of privatisation has been implemented, an Antitrust Authority has been created and more attention to competition has been paid. Many sectors have been liberalised (electricity, telecommunication, natural gas; retail). The crisis of Italy's state-owned companies dragged on for more than 20 years, though not without a few moments of recovery, when managerial skill combined with some favourable developments in the political situation. On the whole, through the seventies and eighties, static and dynamic inefficiencies increasingly hampered both large private and state-owned companies. The former went through a "stop and go" process, in which long-delayed adjustments would be effected abruptly[44]: costs, both in long-term strategies and investment and in workers' conditions, were high. Many state-owned companies came to a virtual standstill. Both presented their shareholders and the general public with dramatic examples of abuses of control and - with a few notable exceptions - largely failed to develop multinational strategies. The steady growth over two decades of the small enterprises-sector partly made up for these swings. But too many of its results have come at the unquantified cost of tax evasion, aided by the fact that personal and company interests are often inextricably linked, particularly in the model of family control; and too many opportunities for growth - to go "big" - have been missed due to failures of corporate governance.

By the beginning of the 1990's, increasing pressure stemming from these failures, together with stricter constraints on state funding from the European Community, the liberalization of capital mobility and an upheaval in the political market[45], led authorities to

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[44] See Barca and Magnani (1989).

[45] A series of electoral reforms resulted in a British-style, first-past-the-post electoral system. At the same time judicial inquiries into political corruption overturned the political equilibrium that had prevailed for the entire postwar period, with the disintegration of the two leading government parties, the DC and the

take some steps. The decade of the nineties saw a thorough overhaul of the role of public intervention in the Italian economy, cutting back direct State management of economic activities and revising the rules governing the conduct of private enterprises.

In particular, privatization of the state-owned enterprises gradually gathered support in Parliament and among the public. Some privatization responded in part to the actions of the European Commission regarding state subsidies to corporations and the related need to adjust the finances of several major state corporate groups. In 1992, following the EC currency crisis and the devaluation of the lira, the government finally passed a strong privatization plan, calling for the sale of all the productive enterprises controlled by the State. The reasoning behind the strategy was twofold: on the one hand, the need to curb the rise of a huge and mounting public debt; on the other, the desire to improve the competitiveness of the Italian industrial apparatus, bringing more small savers into the financial market. An important role was played by the widespread feeling that the sphere of social life controlled by the political parties had to be drastically circumscribed.

The privatization process, which began its operational phase in 1993, can be considered as one of the largest ever realized in a European country. It generated total gross proceeds of more than 164 trillion lire (85.000 millions euros) between 1993 and 2001 (Tab. 3), nearly 8 per cent of the average GDP for those years. In the last three years proceeds averaged 1.8 per cent of GDP. By way of comparison, in the period of most intensive privatization in the UK, between 1985 and 1995, annual proceeds averaged 1.2 per cent of GDP. This process implied an increase in market capitalization of the Italian stock market that was 1,400 trillion lire in 2000 (714 billion euros) equal to 65 per cent of GDP. Also due to the public offerings of shares during the privatization process the concentration of ownership has declined in the second half of the nineties.

In 1998 the successful leveraged takeover of Telecom Italia (former State-owned monopolist, privatized in 1997), one of the largest hostile takeovers ever made in Europe, has implied a big change in the lethargic Italian market for corporate control.

The salient event of the decade in the area of regulatory reform of the markets was Law 287 of 10 October 1990, "Antitrust Law", which instituted a Competition Authority.

A new Banking Law was introduced in 1993 (Law n. 385 1 September 1993) eliminating the prohibition for banks to purchase shares in non-financial corporations and the regional and maturity specialization of banks. Banks can now play a much more active role.

The option of a market relying on broad-based popular shareholding and on the market for corporate control requires modification of the civil code to safeguard the rights of minority shareholders and guarantee greater transparency in corporate management. It also requires more effective supervision of the stock market by the regulatory authorities.

PSI. This transition is still under way, with intensive debate over the new constitutional rules that should be adopted.

A new law was passed in February 1998 (Legislative Decree n.58, 24 February 1998) on financial markets, securities and corporate governance. In particular, new rules for corporate governance based on international standards have been adopted.

On takeover bids, the new rules are based on the obligation for a party to bid for all of a company's ordinary shares once it has purchased more than 30 per cent of the company's capital (mandatory bid rule). Other significant innovations are the admission of an auction system for competing bids and the possibility for shareholders' meeting to authorize defensive tactics against hostile bids. In the area of corporate disclosure, the scope of some reporting requirements has been broadened to cover unlisted companies that have issued widely held financial instruments. With the aim of making the ownership of listed companies transparent, the new law confirms the requirement to notify the Stock Market Authority of equity interests that exceed 2 per cent. The new law also enhanced the transparency of shareholder agreements, limiting their maximum duration to three years. If the parties have not fixed an expiry date for the agreement, they may withdraw at any time after giving notice.

Shareholders with at least a 1 per cent interest in a company may engage qualified intermediaries (banks, securities firms, asset management companies or specialized firms) to solicit proxies from the other shareholders for use in the general meeting. The votes for which proxies have been collected are cast by the delegated shareholder or, at the latter's behest, by the intermediary that was engaged to carry out the solicitation.

The role of a listed company's board of auditors in exercising control on the running of the company has been strengthened by rationalizing the division of accounting-related tasks between the board and the external auditors.

The rights of minority shareholders have therefore been more protected.

The other essential condition for a new system of corporate governance to supplant the obsolete devices still in place is the emergence of control-oriented, activist financial institutions. The opportunity to develop universal banking has been reinforced and banks are now allowed (although subject to restrictions) to acquire equity interests in non-financial companies. For the corporate culture of the banks to change, however, the legal framework is inadequate. Banks need to have a strong incentive to undertake a new role, and this absolutely requires their privatisation.

The previous equilibrium based on the interaction between large family-controlled firms and large State-owned enterprises along with the key role of Mediobanca no longer exists. The privatisation process has basically eliminated the role of the State as shareholder. Mediobanca, since the death of its President E. Cuccia, has been trying to keep its balancing role in family capitalism, but with little success. Family capitalism is still in power, most of the country large groups are still family controlled and small enterprises rarely increase in size.

The issue remains open whether the attempts to import "institutions" made during the last decade will enhance a new institutional equilibrium or rather this will have negative effects due to inconsistencies within the structural features of the economy. The above-mentioned new Financial Act (n.58/1998), for instance, entitled small shareholders to new rights in order to protect their interests, and this in turn implies a more frequent recourse of courts to enforce these rights. So far, empirical research has shown that courts are not equipped to handle these kinds of legal conflicts, so the impact of the new law is quite small (Enriques, 2001).

A new law on takeovers designed to protect minority shareholders has not produced the expected results in the recent case of the second transfer of the controlling stake of Telecom Italia from the previous raider Colaninno to the Pirelli group while the Agnellis have expanded their control to the energy sector. Privatisations do not seem to upset the institutional stability of corporate family capitalism, but rather to widen its sphere of influence.

8. Conclusion

At the beginning of the nineties, the Italian private corporate sector had still failed to undergo a managerial revolution. In the wishes of some reformers another failure - that of the public sector firms - could have pushed the advent of a new managerial model based on the "private" public company. Privatization would not only have meant of the end for the state-owned companies, but also a new beginning for the private sector. There, the family control of large corporations should have been replaced or, at least, integrated by one of the forms of anonymous managerial capitalism (possibly in its "American version") and a different type of Italian capitalism should have emerged (for a summary of the types of Italian Capitalism see table 4).

While some changes, such as the growth of the stock exchange, would seem to be pointing in the direction desired by the reformers, in other respects traditional family capitalism is expanding its control of the Italian economy and has even "purified" its mechanisms of transmissions of economic power from any sort of spurious interference. No Cuccia is present any longer to supervise the quality of the replacement of one generation by the next (or by the following generation) and no manager like Romiti can be trained in the public sector and then imposed by a Cuccia on the private sector when the "family-self-appointed managers" fail. A pessimist may argue that, while the public sector corporations have been privatised, the Italian private corporate sector lacks both the complementary institutions necessary for the working of managerial capitalism and those necessary for the survival of family capitalism. We can only hope that it isn't as bad as it sounds.

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Table 1

Main shareholders of "key companies" of three major Italian groups: 1947 e 1993[(1)]

Fiat Group		Pirelli Group		Falck Group	
Shareholders	Shares	Shareholders	Shares	Shareholders	Shares
FIAT SPA (1947)		**PIRELLI SPA (1947)**		**A.F.L. FALCK (1947)**	
Agnelli family	*70,2*	*Pirelli family*	*12,9*	*Falck family*	*73,1*
Persons (37)	*10,5*	*persons (75)*	*23,2*	*persons (40)*	*11,8*
Vatican	*0,4*	*banks (4)*	*2,6*	*Vatican*	*0,7*
Banks (10)	*2,8*	*non-banking firms (11)*	*2,9*	*non-banking firms(3):*	*14,4*
non-banking firms	*2,5*	*"others"*	*58,4*	*"others"*	*0,0*
"others" (2207)	*13,6*				
FIAT SPA (1993)		**PIRELLI & C. (1993)**		**A.F.L. FALCK (1993)**	
Agnelli family	*24,8*	*Pirelli family* (5)	*8,7*	*Falck family (6)*	*32,3*
via IFI* (2)	18,1	*banks*	*16,4*	*banks*	*4,8*
via IFIL* (3)	1,9	Mediobanca*	10,0	IMI	4,8
via Fimepar (4)	4,8	Banque Indosuez	6,4	*non-banking firms*	*28,3*
Banks	*11,0*	*non-banking firms*	*32,9*	Italmobiliare * (Pesenti)	11,8
Istituto San Paolo	3,4	GIM* (Orlando)	6,7	Siderca Techint * (Rocca)	5,9
Mediobanca*	3,2	SMI* (Orlando)	3,6	Ilva* (IRI)	4,9
Deutsche Bank*	2,4	Gemina*	5,3	Finarvedi * (Arvedi)	4,7
Banco di Roma	2,0	SAI* (Ligresti)	5,0	Sofinda* (Danieli)	2,9
non-banking firms	*4,8*	CAMFIN* (Tronchetti Provera)	5,0	Pirelli & C.*	2,0
Assicurazioni Generali*	2,4	CIR* (De Benedetti)	4,4	Ras *	1,0
Alcatel *	2,0	SOPAF* (Vender)	2,9	*"others"*	*34,6*
"others"	*59,4*	*"others"*	*42,0*		
* Belonging to shareholders' voting and block agreements		* Belonging to shareholders' voting and block agreements		* Belonging to shareholders' voting and block agreements	

Source: F. Barca, F. Bertucci, G. Capello, P. Casavola (1997), *La trasformazione proprietaria di Fiat, Pirelli e Falck dal 1947 a oggi, in F. Barca* (a cura di), *Storia del capitalismo italiano, dal dopoguerra a oggi*, Roma, Donzelli.

(1) As a percentage of total voting capital , ordinary and preferred.. Number of shareholders - when known - in brackets.

Table 2

The control-ownership leverage in three major Italian Groups (1)

Years	Fiat	Pirelli	Falck
1947	1,9	8,9	2,5
1993	17,9	52,6	4,4

Source: F. Barca, F. Bertucci, G. Capello, P. Casavola (1997), *La trasformazione proprietaria di Fiat, Pirelli e Falck dal 1947, in F. Barca* (cura di), *Storia del capitalismo italiano, dal dopoguerra a oggi*, Roma, Donzelli.

(1) Ratio between group's net share capital and share capital held by founding family.

Table 3 - MAIN PRIVATISATION IN THE NINETIES

Corporation (Group)	Method of sale	Percentage sold	Gross proceeds in billions of lire (millions of euros)
1993 – Italgel (IRI)	Private agreement	62.12	431
Cirio-Bertolli-DeRica (IRI)	Private agreement	62.12	311
Credito Italiano (IRI)	Public offering	58.09	1,801
SIV (EFIM)	Auction	100.00	210
Total for year			**2,753**
	Public offering	32.89	2,150
1994 - IMI - 1st *tranche*			
COMIT (IRI)	Public offering	54.35	2,891
Nuovo Pignone (ENI)	Auction	69.33	699
INA - *1st tranche*	Public offering	47.25	4,530
Acciai Speciali Terni (IRI)	Private agreement	100.00	624
SME - *1st tranche (IRI)*	Private agreement	32.00	723
Other companies *(ENI)*			1,087
Total for year			**12,704**
	Auction	40.00	1,000
1995 - Italtel (IRI)			
Ilva Laminati Piani (IRI)	Private agreement	100.00	1,929
Enichem Augusta (ENI)	Auction	70.00	300
Other companies *(ENI)*			336
IMI - *2nd tranche*	Private agreement	19.03	1,200
SME - *2nd tranche (IRI)*	Accept takeover bid	14.91	341
INA - *2nd tranche*	Private agreement	18.37	1,687
ENI - *1st tranche*	Public offering	15.00	6,299
ISE (IRI)	Auction	73.96	370
Total for year			**13,462**
	Auction	84.08	302
1996 - Dalmine (IRI)			
Italimpianti (IRI)	Auction	100.00	42
Nuova Tirrena	Auction	91.14	548
SME - *3rd tranche* (IRI)	Accept takeover bid	15.21	121
INA - 3r*d tranche*	Conv. Bond issue	31.08	3,260
MAC (IRI)	Auction	50.00	223
IMI - *3rd tranche*	Public offering	6.94	501
Montefibre (ENI)	Public offering	65.00	183
ENI - *2nd tranche*	Public offering	15.82	8,872
Total for year			**14,051**
	Public offering	17.60	13,230
1997 - ENI - 3rd tranche			
Aeroporti di Roma (IRI)	Public offering	45.00	541
Telecom Italia	Core investors + public offering	39.54	22,883
SEAT editoria	Core investors + public offering	61.27	1,653
Banca di Roma (IRI)	Public offering + bond issue	36.50	1,900
Total for year			**40,207**
	Public offering	18.75	1,140
1998 – SAIPEM (ENI)			
ENI - *4th tranche*	Public offering	14.83	12,995
BNL	Public offering	67.85	6,707
Total for year			**20,842**
	Public offering	35.50	34,828
1999 - ENEL			
Autostrade (IRI)	Auction + public offering	57.00	8,105
Total for year			**42,933**
	Private agreement	30.00	4,911
2000 - Autostrade (IRI)			
Finmeccanica (IRI)	Public offering	43.70	5,505
Aeroporti di Roma (IRI)	Private agreement	51.20	1,328
Banco di Napoli	Public offering	16.16	494
Total for year			**12,238**
	Accelerate Book Building	5.00	5,268
2001 - ENI - *5th tranche*			
			(2,721)
Total proceeds			**164,458**
			(84,935)

Sources: Company accounts (various years); Ministry of the Treasury, *Relazione sulle privatizzazioni* (various years); Financial Press.

Table 4

	Financial markets	**Corporate governance**
ITALIAN CAPITALISM "MARK I"	Universal banks (German type) Till 1907 relatively developed stock mkt;	- process of ownership concentration - creation of pyramidal group; high bank/ corporate ownership; cross shareholding
ITALIAN CAPITALISM "MARK II"	- Separation of banks and non-financial firms (i.e. Glass-Steagal Act) - Illiquid capital market; - Weaker financial mkt pressures; - 80% of the banks are state-owned	- creation of big state-owned groups; - ownership concentrated and stable; - high family and corporate shareholding; - pyramidal groups - high cross-shareholding
ITALIAN CAPITALISM "MARK III" (1970s-80s)	- liberalization of financial mkt - liberalization of banking sector - privatization of banks	- emergence of a very important small and medium firms sector; - deverticalization of large firms; - crisis of many state-owned groups; - Mediobanca
ITALIAN SYSTEM IN THE 1990's	- new banking law: banks are free to own shares; universal banking is allowed; process of banking mergers; - privatisation enhances development of a more liquid stock market; - new financial law: higher transparency; more information; mandatory bid over 30% of capital	- reduction in ownership concentration; - no institutional investors; - cases of hostile takeovers; less collusive climate; - crisis of Mediobanca - resurgence of family capitalism; - emerging of some new groups