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WHAT DO SHAREHOLDERS' COALITIONS REALLY WANT? EVIDENCE FROM ITALIAN VOTING TRUSTS

by Gianfranco Gianfrate

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Senza dubbio, ai miei Genitori

Abstract

Nell'ambito della letteratura finanziaria in tema di *ownership structure*, alcuni recenti contributi empirici (La Porta et al.,1999; Claessens et al., 2002; Faccio and Lang, 2002) hanno messo in evidenza la netta prevalenza, nei paesi maggiormente sviluppati, di sistemi a proprietà concentrata, ridimensionando, di fatto, il ruolo della public company *à la Berle and Means* che è stata (più o meno esplicitamente) il modello di riferimento per almeno due generazioni di ricercatori.

Se dunque la presenza di grandi azionisti di controllo, nell'ambito degli assetti proprietari delle imprese, rappresenta la norma più che l'eccezione, la letteratura internazionale si è progressivamente focalizzata sulle ragioni che spiegano l'esistenza di azionisti che, concentrando la propria ricchezza in ampie quote azionarie di singole aziende, si sobbarcano, de facto, importanti costi legati alla mancata diversificazione del proprio portafoglio. La spiegazione che ha incontrato il maggior favore fra gli studiosi, è riconducibile alla presenza di benefici privati di cui gli azionisti di controllo godrebbero a discapito degli azionisti di minoranza.

Benché la letteratura in tema di benefici privati del controllo non abbia ancora raggiunto, nel suo complesso, una soddisfacente sistematizzazione, e abbia, sinora, prodotto solo evidenze empiriche indirette della consistenza di tali benefici (Nenova, 2003; Dyck and Zingales, 2003), tuttavia è crescente il consenso e l'accoglienza di tale impostazione da parte degli studiosi sia di finanza che di diritto. Nell'alveo dell'incontro tra diritto e finanza, alcuni autori (segnatamente Bebchuk et al., 2000) hanno, in particolare, sottolineato come le distorsioni derivanti dalla presenza di benefici privati siano spesso ulteriormente esacerbate dall'adozione di meccanismi di separazione tra proprietà e controllo quali le piramidi societarie, l'emissione di azioni senza diritto di voto e le partecipazioni incrociate.

Il presente lavoro si pone l'obiettivo di analizzare il ruolo dei patti di sindacato, in Italia, come ulteriore strumento di separazione tra proprietà e controllo. Dall'analisi di 74 patti siglati nel periodo 1998-2003, si è in particolare studiata, con un approccio di *financial contracting* (Kaplan and Strömberg, 2003), l'allocazione dei diritti di proprietà (*cash-flow rights*), di voto e di nomina dei consiglieri di amministrazione (*board rights*) tra i vari membri dei patti di sindacato presi in esame. Dall'analisi emerge una sostanziale divaricazione tra diritti di voto e *board rights*: il patto, nel complesso, controlla mediamente più del 50% dei diritti sia di proprietà che di voto, ottenendo, però, il diritto di nominare, in media, circa il 90% dei membri del consiglio di amministrazione. Il maggior azionista all'interno del patto, con una quota media inferiore al 30% dei diritti di proprietà e di voto, ottiene, invece, il diritto di nominare quasi il 60% dei consiglieri di amministrazione, e, nella maggior parte dei casi, ricopre direttamente incarichi manageriali all'interno della società controllata dal patto .

Coerentemente con questi risultati, la tesi propone un modello interpretativo del funzionamento dei patti di sindacato basato sulla strutturazione di coalizioni di azionisti che detengono complessivamente una quota di controllo della società tale da neutralizzare possibili scalate ostili, garantendo al contempo (come collante) l'estrazione condivisa di benefici privati del controllo. Il modello mostra che la congiunta interazione tra separazione di proprietà e controllo, da un lato, e benefici privati del controllo, dall'altro, blocca un ventaglio di potenziali transazioni che sarebbero efficienti dal punto di vista del mercato (ovvero degli azionisti di minoranza) ma che, di fatto, non lo sono per i membri del patto.

Le ipotesi del modello sono testate mediante un *event-study* effettuato su un campione di 56 annunci relativi a patti di sindacato avvenuti nel periodo 1995-2003. Coerentemente con le ipotesi formulate, l'analisi evidenzia reazioni, statisticamente significative, da parte del mercato, all'annuncio della costituzione/rinnovo di patti, mediamente pari al -5,8% nel giorno dell'annuncio e in quello successivo, e pari, invece, al +7,8% nel caso di scioglimento del patto. In quest'ultimo caso, inoltre, i corsi azionari continuano ad incorporare, anche al termine del periodo studiato, una maggiorazione del prezzo, mediamente pari al 5%, che può essere interpretata come il "premio" riconosciuto dal mercato per la maggiore contendibilità della società. Tali risultati sono coerenti con l'ipotesi dell'esistenza di "*entrenchment effects*" (Stulz, 1988) nel legame tra concentrazione della proprietà e valutazioni di mercato: la presenza, nell'ambito della compagine azionaria, di *large shareholders* raccolti in un patto di sindacato si riflette in una più bassa valorizzazione del titolo sul mercato.

Infine, le evidenze empiriche emerse dall'analisi sollevano alcuni dubbi in merito all'adeguatezza del regime di pubblicità dei patti previsto dal TUF. La reazione anomala, e statisticamente robusta, individuata nel corso dell'analisi implica la presenza, negli annunci relativi ai patti di sindacato, di informazioni in grado di "*influenzare sensibilmente il prezzo degli strumenti finanziari*". Tale constatazione suggerirebbe, quindi, un trattamento delle comunicazioni al pubblico sui patti, allineato alle modalità della comunicazione "*price sensitive*" prevista dall'Articolo 114, piuttosto che secondo i tempi più dilatati previsti, specificamente per la comunicazione dei patti, dall'Articolo 122.

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"In countries with poor protection of minority shareholders, losing control involuntary and thus becoming a minority shareholder may be such a costly proposition in terms of surrendering the private benefits of control that the controlling shareholders would do everything to keep control"

LA PORTA R., F. LOPEZ-DE-SILANES, A. SHLEIFER

1.1 Ownership Structure in the Finance and Law Literature

1.1.1 Ownership Structure: Myths and Reality

The classic study of the ownership and control of corporation is the book *The Modern Corporation and Private Property* by Adolph Berle and Gardiner Means, published in 1932. On the basis of the (rudimental) data available about US corporations, they concluded that:

> *"The separation of ownership from control has become effective [...] a large body of security holders has been created who exercise virtually no control over the wealth which they or their predecessors in interest have contributed to the enterprise. The separation of ownership from control produces a condition where the interests of owner and of ultimate manager may, and often do, diverge, and where many of the checks which formerly operated to limit the use of power disappear."*

For at least two generations of scholars, this book has fixed the image (and the stereotype) of the modern corporation as one run by professional managers substantially unaccountable to shareholders. In particular, the book stimulated a huge amount of both theoretical and empirical "managerialist" literature. For example, Manne (1965) argued that the market for corporate control, not management, governs the modern corporation. In general, the modern field of corporate finance, as a whole, has developed upon the

image of a widely held corporation, as can be seen in key contributions like the one by Grossman and Hart (1980) who cast doubt about the effectiveness of the market for corporate control, or the famous "agency cost" theory based on the Jensen and Meckling (1976) contribution. Jensen, in particular, predicted a pessimistic "eclipse of the public corporation" through a move to private corporations highly leveraged.

In recent years, several empirical studies have begun to question the actual validity of the widely held corporation archetype: Demsetz and Lehn (1985), Shleifer and Vishny (1986) and Morck, Shleifer and Vishny (1988) show that even among the largest US corporation, there is, at least, a "modest concentration of ownership". Holderness, Kroszner and Sheehan (1999) compare a comprehensive cross-section of roughly 1.500 US publicly traded companies in 1935 with a modern benchmark of more than 4.200 listed companies in 1995. They find that managerial ownership was higher in 1995 than in 1935. The mean percentage of common stock held by firm insiders (as a whole) rose from 13 percent in 1935 to 21 percent in 1995. Median holdings doubled from 7 percent to 14 percent. Although the very largest firms have similar ownership percentages in both periods, a firm-weighted average is higher in 1995 than in 1935, when Berle and Means wrote their study.

Indeed, only in more recent years, scholars have begun to shed the light on control of corporations outside the United States. Quoting Barca and Becht (2001), "*in, fact, such has been the influence of Berle and Means that the textbook description of dispersed ownership and separation of ownership and control has been presumed to be universally applicable. But over the last few years, evidence has emerged that has questioned this view*". Some outstanding empirical contributions have been recently published in order to fill the gap especially about the ownership patterns of large publicly traded firms in different countries.

Franks and Mayer (1995) identify two distinct types of ownership and control structures: the "insider" and "outsider" systems. The latter is commonly observed in the Anglo-Saxon countries, especially USA and UK, and it is characterized by a majority of equity held by financial institution (i.e. pension funds and life assurance companies) and individual shareholders[1]. A quite different situation, labelled "insider system", emerges

[1] United States are characterized by an unfavorable regulation of large blockholdings. Among USA rules discouraging shareholder action are disclosure requirements, prohibitions on insider trading and short-

in Continental Europe where (relatively) few companies are listed on stock markets and those listed companies have a remarkably high level of concentration of ownership. In particular, the authors pointed out that in more than 80% of the largest 170 companies listed in France and Germany, there is a single shareholder owning more than 25% of the shares; in more than 50% of companies, there is a single majority shareholder. The corresponding figures for the UK were 16% of the largest 170 listed companies having shareholders owning more than 25% of shares and 6% had single majority shareholders.

Furthermore, Franks and Mayer note that the ownership of Continental European corporations is primarily concentrated in the hands of two groups: families and other companies. Pyramids, cross-shareholdings and complex webs of inter-corporate shareholdings are commonplace in some countries. While ownership by the State is often appreciable, they also observe that bank ownership of corporate equity is generally quite modest, despite the huge attention that scholars have devoted to the role of bank shareholdings in cementing the bank-firm relationship.

However, the true "shake" amongst academicians and researchers, about the validity of the Berle and Means picture, came in 1999 when La Porta et al. published the "*Corporate Ownership Around the World*" article. In that contribution, the authors examine the ownership structure of the 20 largest publicly traded firms in each of the 27 generally richest economies around the world. The key point of the article is to find, wherever possible, the identities of the *ultimate owners* of capital and voting rights in firms. As a general result, the article shows that the "*Berle and Means corporation*" is far from universal, and is quite rare for some definitions of control. Furthermore, the so-called "German model" of bank control through equity appears uncommon[2]. Instead, controlling shareholders, usually families or the State, are present in most large companies. Typically, these large shareholders have control rights in firms in excess of their cash-flow rights, largely thanks to the use of pyramids (*infra* § 1.1.2), but they also participate in management.

This contribution stimulated a further huge effort in the empirical research about corporate ownership around the world. Claessens et al. (2000) investigate the separation

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swing trading, rules imposing liability on "controlling shareholders", limits on institutional shareholdings in a single company and fiduciary duty rules.

[2] A recent contribution from Miwa and Ramseyer (2004) points out that also the famous *keiretsu* governance model is less common in Japan than usually thought.

of ownership and control in 2.980 publicly traded companies in 9 East Asian countries[3], where control appears to be mainly enhanced through pyramid structures and cross-holdings among firms. Moreover, the separation of management from ownership is rare, and the top management of about 60% of firms that are not widely held is related to the family of the controlling shareholder.

Faccio and Lang (2002) collect ultimate ownership data for a large sample of 5.232 listed companies of 13 Western European countries[4], including a large number of medium- and small-sized corporations, taking into account both non-financial and financial companies. As a general result, the authors show that Western European firms are most likely to be widely-held (36,93%) or family controlled (44,29%). Widely-held firms are especially important in the UK and Ireland, while family control is more important in Continental Europe. Widely-held firms are more important for financial and large firms, while families are more important for financial and small firms. In some countries of continental Europe, the State also controls a significant proportion of firms, especially the largest.

The study reports also the use of legal/financial devices that give the controlling shareholders control rights in excess of their cash flow rights (*infra* § 1.1.2). Dual class shares are used by few firms in Belgium, Portugal and Spain, but by 66,07%, 51,17%, and 41,35% of firms in Sweden, Switzerland, and Italy. Pyramids and holdings through multiple control chains are used to control only 19,13% and 5,52% of listed firms respectively, being less important for family-controlled firms and more important for firms controlled by the State and by widely-held financial institutions. The 53,99% of European firms have only one controlling owner, while more than two-thirds of the family-controlled companies have top managers from the controlling family.

Overall, there are some slight differences from the findings by La Porta et al. (1999), in that Faccio and Lang found fewer State-controlled firms and more widely-held companies, fewer pyramids, and more dual-class shares. Compared to the results of Claessens et al. (2000) for East Asia, families control a higher proportion of European companies; each family controls fewer firms on average; top families control a lower proportion of total stock market capitalization; a higher proportion of family-controlled

[3] Hong Kong, Indonesia, Japan, South Korea, Malaysia, the Philippines, Singapore, Taiwan, and Thailand.

companies are directly managed by family members; and the largest shareholder is less often alone, but averages much higher cash-flow rights, control rights and ratio of cash-flow to voting rights. The authors argue that these differences could be due to weaker law enforcement in Asia that allows controlling owners to achieve effective control of a large number of firms by controlling and owning a much smaller part of each firm.

This brief exposition of the more recent advancements in the ownership structure literature, presents a very different picture of the ownership structure of the modern corporation than that suggested by Berle and Means and widely accepted in the finance literature and taught in academia. The Berle and Means archetype emerges only as a common organizational form for large firms in the richest common law countries and especially in USA.

But, looking outside the United States[5], particularly at countries with poor shareholder protection, even the largest firms tend to have controlling shareholders: sometimes the State, but, more often, a family (usually the founder of the firm or his descendants). The power of these controlling shareholders is evidently not checked by other large shareholders. Overall, the evidence emerging from the empirical recent contributions suggests that the theory of corporate finance relevant for most countries, including Italy, should focus on the incentives and opportunities of controlling shareholders to both benefit and expropriate the minority shareholders.

1.1.2 Mechanisms of Separating Ownership and Control

The previous paragraph underlines the wide adoption of both legal and financial devices whose objective is to separate the control from ownership, or more precisely, from the equity claims on a company's cash-flow. This separation very often reaches extreme levels enabling a shareholder to control a firm while holding only a very small

[4] Austria, Belgium, Finland, France, Germany, Ireland, Italy, Norway, Portugal, Spain, Sweden Switzerland and the UK.

[5] However, Anderson and Reeb (2003) observe that families are present in one-third of the S&P 500 and account for 18 percent of outstanding equity. Contrary to the common wisdom, the authors find that family firms perform better than non-family firms. Additional analysis reveals that the relation between family holdings and firm performance is nonlinear and that when family members serve as CEO, performance is better than with outside CEOs. Overall, these results are inconsistent with the hypothesis that minority shareholders are adversely affected by family ownership, suggesting that family ownership is an effective organizational structure even in US.

fraction of its equity. In particular, this ownership configuration is usually termed "controlling-minority structure" (Bebchuk et al., 2000) and it resembles a controlling structure (in which a large block-holder owns a majority of a company's shares) insofar as it insulates the controller from the market for corporate control. But, at the same time, the controlling-minority structure resembles the dispersed ownership structure insofar as it places corporate control in the hands of an insider who holds a small fraction of the firm's cash-flow rights.

Bebchuk et al. (2000) extensively analyze the consequences and the agency costs of arrangements for separating control from cash-flow rights. In particular, they show these arrangements have the potential to create very large agency costs – costs that are an order of magnitude larger than those associated with controlling shareholders who hold a majority of the cash-flow rights in their companies.

Furthermore, Bebchuk et a. (2000) formalise the three basic mechanisms that allow the full control of a company through the actual ownership of only a minority of the cash-flow rights attached to the firm's equity: differential voting rights, stock pyramids and cross-ownership.

Differential Voting Rights

The mechanism used in the separation of ownership and control through the issuance of two (or more) classes of stock with differential voting rights is straightforward. From a theoretical point of view, the basic idea simply consists in attaching all voting rights to the fraction α (which represents the fraction of the firm's equity cash-flow rights held by the controlling-minority shareholder) of shares that are assigned to the controller, while attaching no voting rights to the remaining shares which are distributed to the other shareholders[6].

Despite the basic simplicity of differential rights shares, dual class shares are less common than one could expect. This is mainly due to the fact that Corporate Law regimes restricts, especially in Anglo-Saxon countries, both the voting ratio between high- and low-vote shares and the numerical ratio between high and low-vote shares that a firm is permitted to issue (Bebchuk et al., 2000).

The most extensive cross-countries analysis of differential rights shares is provided by Nenova (2003) who studies a sample of 661 dual-class firms in 18 countries in 1997. In particular, the analysis is based on the measurement of the total value of all votes composing the control block, which is assumed to be 50% of the voting power. It is showed that this "value of control-block votes" is significant in magnitude and varies widely across countries. Control-block votes are valued at more than a quarter of company market capitalization in countries assumed to have a low investor protection regime (29% in Italy). In contrast, the value of control-block votes in Scandinavian and Anglo-Saxon countries results close to zero. The interesting contribution of the paper is the isolation of the role of a stricter legal environment in shaping the magnitude of control-block votes. Thus, the average (unadjusted) value of control-block votes is 4,5% in common law countries and 24,5% in French legal origin countries, where investor protection is assumed weaker.

This finding is consistent with the hypothesis that parties in control of a corporation can extract private benefits to the exclusion of dispersed shareholders. The weaker laws lower expropriation costs thus encouraging higher control benefits, which in turn pushes up the value of control-block votes. Quality of investor protection, takeover rules on pricing and mandatory offers, corporate charter provisions, and the extent of law enforcement explain 68% of the systematic variation in the value of control-block votes.

The impact of investor protection laws and control transfer regulations are of comparable magnitude, but proper enforcement is the key. An example could prove effective. The value of control-block votes is 48% of the firm value, on average, in the case of a widely held firm that operates in the weakest law environment. An improvement of law enforcement from the lowest to the highest in-sample value decreases the value of control-block votes to 31%. This figure drops further down to 20% if investor protection is raised from lowest to highest in-sample value. The same improvement in takeover rules takes the value of control-block votes down to 8%. Finally, moving from full to no use of power-concentrating charter provisions takes the value of control-block votes down to 5%.

[6] For example, the voting shares of IFI are fully owned by the Agnelli family, while the "azioni prilegiate" (a class of stocks characterized by a lower level of voting rights) are widely held by outsiders.

Italian companies with listed common shares were allowed to issue non-voting shares in 1974 by Law 216. Restricted voting shares may not exceed 50% of total equity capital. Some include an option which allows to convert them into common shares. Holders of non-voting shares are represented by a delegate at common shareholders' meetings. They enjoy special pecuniary benefits:

- A minimum dividend equal to 5% of par value has to be paid to non-voting shares when net profits are sufficiently high; arrears on minimum dividend distribution is cumulated for the following two years;
- When dividend is paid out to common shares, an extra dividend of at least 2% of par value has to be distributed to non-voting shares;
- Any distribution of profits, in any form, must give non-voting shares at least the same pecuniary proceeds as common shares;
- Upon liquidation, non voting shareholders enjoy seniority over common shares.

It has been already pointed out that the differential voting rights shares, in general, are less common than scholars expected. Furthermore, a clear trend in dual-class stock unifications (Pajuste, 2003) is emerging at international level. In particular, in Italy the growing favour toward the "one share-one vote" equity structure is basically motivated by the following reasons (Bigelli, 2004):

- The sharp decrease in interest rates (due to both the joining of European Monetary Union and to the a generalised prolonged phase of low interest rates) makes non voting shares relatively too expensive (bearing a minimum 5% dividend per share) in comparison with the cost of corporate debt;
- The increasing internationalization of institutional investors' base leads to a unfavourable approach of the market toward shares without voting rights;
- In order to improve stock liquidity which can be enhanced entering major market indexes (i.e. Mib30, Midex), some listed companies may choose to unify non voting shares (which are not taken into account in the definition of such indexes).

Bigelli (2004) reports 43 Italian unifications in the 1974-2003 period. He develops a model that quantifies the wealth effects of unifications on both voting and

non-voting shares, showing that stock unifications may result in a form of expropriation of minority shareholders. In particular, the author points out that "controlling shareholders take advantage of unifications by engaging in the following activities some months before the unification announcements: buying consistent blocks of non-voting shares, selling voting shares or approving stock options plans on non-voting shares". Through the analysis of 5 cases studies, he shows a negative market reaction (ranging from a minimum -4,3% to a maximum of -10,4%) at the announcement of unifications, confirming that dual class unifications can expropriate minority (voting) shareholders to the benefit of the controlling shareholders.

Pyramids

In contrast with dual (or multiple) class shares, corporate pyramids could be created through a single class of shares. The generalised formalisation (Bebchuk et al., 2000) of the pyramidal structure is based on a sequence of $n \geq 2$ companies, in which the controller holds a fraction s_1 of the shares in company *1*, company *1* holds a fraction s_2 of the shares in company 2, and so on. As long as $s_i \geq 2$, $i = 1, \ldots, n$, the controller exercises formal control over the companies. At the cash-flow level, the controller shareholder holds a fraction

$$\alpha = \left(\prod_{i=1}^{n} \right) s_i$$

This formula can be generalised: since setting n large enough the product $\left(\prod_{i=1}^{n} \right)$ can become as low as desired, then for any fraction α, however small, there is a pyramid such that a controlling shareholder could completely control a company holding no more than the percentage α of the company's cash-flow rights (Bebchuk et al., 2000)[7].

[7] For example, in a three-levels pyramid with s_i = 50% at each level, the controlling shareholders fully controls the company at the bottom of the pyramid owning only 12,5% of its cash-flow rights.

Pyramidal structures are quite common among Italian listed companies. This kind of ownership mechanism has been recognised by the Italian regulator since the late 1940s, but no measures were taken until recently to limit its growth or to attenuate the problems associated with it. In contrast, pyramids have been favoured by a neutral tax policy (i.e. dividends are taxed only once, no matter how many levels the control chain has), and by the absence of any legal provisions to prevent conflicts of interests between the ultimate controlling shareholder(s) and minority shareholders present at the lower levels of the pyramidal structures. This might partially be explained by the consideration that the State itself used pyramids for its own industrial activities and assets (e.g. IRI). Furthermore, the Milan Stock Exchange accepts the listing of both "Chinese boxes" (companies whose sole assets are controlling blocks in other listed companies) and companies at various levels of the pyramids.

Massari (1989) reports that in 1987 the 82,5% of the total Milan Stock Exchange's capitalization belonged to only 21 pyramidal groups. According to a survey (Barca and Becht, 2001) of both listed and unlisted companies, while in 1992 more than half (56%) of Italian corporations belonged to a pyramidal group, by 1996 this value had edged down to 53%. The phenomenon is more common among large companies: virtually all those with 1000 employees or more adopt this structure. The percentage is also high among small and medium-sized companies: 40% of companies with 50-99 employees adopted a pyramidal structure. As a general result, pyramids could be considered as the fundamental form of organisation and control in Italian firms.

An interesting way of measuring the effectiveness of pyramidal groups in obtaining the separation between ownership and control is the evaluation of the "integrated ownership", i.e. the amount of capital the ultimate controlling shareholder has actually supplied (Brioschi et al., 1990). According to this approach, integrated ownership is computed for each listed company with an identified ultimate controlling agent, moving from the latter's direct shareholding along the control chain. If, for example, agent A controls company B with a 50% share and B controls company C with a 50% share, the integrated ownership of A in C is 25%. In 1996, integrated ownership of ultimate controlling shareholders in the set of Italian listed companies was 51%. Interestingly, more than half of all such integrated ownership was accounted for the State. This high degree of integrated ownership reflects a modest separation between

ownership and control: in 1996, on average, ownership of one unit of capital allowed comprehensive control of 1,95 units. This figure, at a granular level, was below average for the State (1,6) and above average for individuals (3,62) and non-financial companies (4,48). Thus, the pyramidal structure seems exploited, in particular by private groups, to maximise external finance.

A recent contribution by Volpin (2002) sheds light on some key aspects of the governance of Italian pyramidal structures. Volpin studies the determinants of executive turnover in Italian publicly traded companies, by focusing on how the ownership and control structure affects the sensitivity of the firm's executive turnover to performance. Furthermore, he evaluates the effect of these same factors on the firm's Q ratio. The general finding of the analysis is that controlling shareholders are entrenched: the probability of turnover and its sensitivity to performance are significantly lower for top executives who belong to the family of the controlling shareholder than for others executives. But interestingly, within pyramidal groups, he founds a significant lower Q ratio (between 13% and 27%) in firms at the bottom of the pyramid. This result seems consistent with the argument that pyramids increase agency problems by creating a wedge between voting and cash-flow rights. A possible explanation is that good managers are promoted to a higher layer of the pyramid. Indeed, the relationship between turnover and performance is weaker in pyramidal groups although the difference is not statistically significant.

Furthermore, turnover is much lower in the company at the top of a pyramid (6%) than in its subsidiaries (16%). This result may be explained by the fact that the controlling shareholders of the group sit as executives of their holding companies and they are entrenched in control. They do so because the benefits of control are larger in the holding company, as suggested by the finding that the voting premium in the holding companies is significantly higher than in subsidiaries.

If pyramids have been popular among Italian listed companies during last decades, more recently the market is showing its dissatisfaction toward pyramids. As a consequence, several groups have started simplifying and shortening their groups[8].

[8] *"Le piramidi societarie, spesso capolavori di ingegneria finanziaria, oltre che il mezzo con cui imprenditori comandavano a spese dei piccoli azionisti e del mercato, sono stati anche una strada spesso obbligata in un capitalismo storicamente privo di capitali. "Ho fatto le nozze coi fichi secchi" ripeteva Enrico Cuccia a proposito di quel capitalismo, di cui si era eretto a padre tutelare, ma a cui allo stesso tempo guardava con perplessità... Nel sistema, però, si avvertono segnali di cambiamento: la globalizzazione dei mercati, in primis quelli finanziari,*

Aganin and Volpin (2003) tracing the history of corporate ownership in Italy, show that while family-controlled pyramids represented 30 percent of market capitalization of Milan Stock exchange in 1950 and increased steadily to 40 percent in the middle of 1980s, more recently they declined to 20 percent at the end of the 1990s. Interestingly, the authors suggest that pyramidal groups enable the firms to take advantage of market optimism, thus listing their subsidiaries during waves of market optimism/overvaluation.

Cross-ownership

Cross-ownership structures consist in companies which are linked by horizontal or vertical cross-holdings of shares that reinforce and entrench the power of central controllers. Bebchuk et al. (2000) demonstrate that for any α, however small, it is possible to construct a cross-ownership structure such that the controlling shareholder will have complete control over the company holding no more than the fraction α of the company's cash-flow rights.

In Italy, for unlisted companies, there are no limits to reciprocal, when the two companies are not in a control relationship with one another. If they are, then the controlled company may not hold more than 10% of the other's shares. The rules for listed companies are more restrictive. The general limit on cross-holdings (including shares held indirectly, as by controlled companies) is 2% if both companies listed. In practice, this provision implies that if a listed company holds more than 2% of another's voting shares, the latter may not exercise the voting rights attached to shares exceeding 2% of the total voting shares in the former and it must sell such exceeding shares within twelve months. Furthermore, if a listed company holds more than 10% of an unlisted company's shares, the latter may not hold more than 2% of the former company's shares; in contrast, if an unlisted company holds more than 2% of a listed company's

pretende trasparenza. Il mercato non tollera certe astuzie, pena la sua allocazione in altri strumenti o Paesi più efficienti. Un pungolo, ma anche una necessità - se non si vuole vedere scendere il già di per sé non elevato afflusso di capitali stranieri - per eliminare, o smorzare, certe storture. La progressiva riduzione delle azioni di risparmio, categoria che a Piazza Affari per decenni è stata il marchio a fuoco del risparmiatore bistrattato, e l'accorciamento delle catene (Telecom Italia l'anno scorso e Gim-Smi quest'anno) sono anche frutto delle spinte che vengono da quel mercato un tempo tenuto in bassissimo conto". From *IlSole24Ore*, 24th April 2004.

shares, the latter may not hold more than 10% of the former company's shares (Barca and Becht, 2001).

The 1998 Reform raised the limits on cross-holdings between listed companies to 5% *sub condicione* that the two general meetings give their consent on the basis of a formal agreement between the two companies neither already owning more than 2% of the other. The Reform also takes into account the connections among groups, specifying that if a company gains control over an other one through a takeover bid, then the votes attached to the shares held by the acquired company that cannot be exercised.

Bianchi et al. (1998) point out the role of circular holdings in Italian ownership structures. In a basic circular holdings structure, company A holds shares in company B, which holds shares in company C, which in turn holds shares in A. This mechanism of separating ownership and control is neither prohibited nor limited by the Italian law. In particular, the authors find that circular holdings each larger than 2% connect 20 groups of companies, representing 63% of the total capitalization of non-State-controlled companies and 36% of the Italian Stock Exchange: 16 groups result to be connected through "triangular" holdings, while the remaining groups are connected by "square" or "pentagonal" holdings.

Cross-ownership among Italian companies played a central role in stabilizing and shaping companies' ownership structure. The rationale of such instrument has been (and still is) the "political" web of ties reciprocally binding the main family-owned companies e financial institutions, generally under the directorship of Mediobanca. Perhaps the cross-ownership ties among largest listed companies are the most apparent symptom of the Italian "crony capitalism"[9].

1.2 The Causes and Effects of Ownership Concentration

The previous paragraph of this chapter points out the fact that forms of concentrating ownership, and so the existence of large shareholders, are much more common in the corporations around the world than previously assumed by both scholars

[9] "*Crony capitalism*" is a pejorative expression, denoting a type of capitalism in which business success is heavily dependent upon one's connections. In such a system, business decisions are significantly influenced by friendships and family ties, rather than by market forces and open competition.

and practitioners. The body of the literature about large shareholders is well developed both at theoretical and empirical level, even if robust evidence about the interactions among large shareholders within corporations is still lacking. In the following pages a brief summary of the literature on this topic is presented. The concept of private benefits of control, introduced by some contributions cited here, will come under scrutiny in the next chapter.

1.2.1 Theoretical Models

At the first glance, the benefits of large shareholders are, at least theoretically, clear: they have both the interest in getting the invested money back and the power to demand it. When control rights are concentrated in the hands of a small number of investors with a collectively large cash flow stake, concerted action by investors is much easier than when control rights, especially votes, are split among many of them (Shleifer and Vishny, 1997). In a more formalised way, it can be said that a substantial minority shareholder has the incentive to collect information and monitor the management, thus avoiding the traditional free rider problem. Furthermore, this kind of controlling shareholder has enough voting control to put pressure on the management, and in extreme cases to oust management through a proxy fight or a take-over.

In this perspective, the first stream of contributions about large shareholders pointed out the benefits due to their role in facilitating take-overs (Grossman and Hart, 1980; Shleifer and Vishny, 1986). A related theme is the well-known trade-off underlying the classical agency problem with moral hazard: the trade-off between optimal risk diversification, which could be obtained only under a fully dispersed ownership structure, and optimal monitoring incentives, which require concentrated ownership. Admati et al. (1994) focused on the monitoring incentives of a large risk-averting shareholder. They show that in equilibrium the large shareholder is expected to finally under-invest in monitoring, because she prefers to diversify holdings thus reducing her incentives or commitment to monitoring. Furthermore, this contribution points out that ownership structures with one large blockholder may be unstable as long as the blockholder gradually reduces her stake by selling small quantities of shares in the secondary market. There is a normative implication emerging from this model: corporate governance could be improved if large shareholders could be subsidised to

hold large blocks. Indeed, the main problem identified in these models is to give greater incentives to monitor to the large shareholders (Becht, et al., 2003).

Summarising this stream of theoretical contributions, what emerges is the idea that if the limited size of a block is mainly due to the large shareholder's desire to diversify risk, then under-monitoring by the large shareholder is generally to be expected.

Apart from the clear benefits produced by large shareholders monitoring, there may also be costs. For, example, large shareholders could use their power to expropriate employees or managers, discouraging them from making costly firm specific investments (Aghion and Tirole, 1997; Burkart et al., 1997, Pagano and Roell, 1998). In this perspective, the presence of large shareholders determines the over-monitoring situation which generally characterises privately held firms (it is argued that one important motive for going public is that the managers want to escape from an "over-beating" owner or venture capitalist).

There is only a short step from over-monitoring to downright expropriation, self-dealing or collusion with management at the expense of minority shareholders. Indeed, a huge stream of literature is pointing out the conflict of interest among shareholders inherent in blockholder ownership structures. This conflict is exacerbated when in addition there is separation between voting rights and cash-flow rights. Many commentators have argued that such a situation is particularly vulnerable to self-dealing by the controlling shareholders. In particular, Bebchuk (1999) shows that if self-dealing is possible under a lax corporate law, it will inevitably lead to concentrated ownership.

If there are both costs and benefits arising from the presence of large shareholders within the ownership structure, the next step is the evaluation of the relative advantages (if any) in comparison with other monitoring systems and especially with the takeover model. Bolton and Von Thadden (1998) argue that one potential benefit of blockholder structures is that monitoring will take place on an ongoing basis. In contrast, a system characterised by dispersed ownership can provide monitoring and intervention only in situations (if at all), through hostile takeovers. On the other hand, dispersed ownership determines an enhanced liquidity on the secondary market. They conclude that, depending on the value of monitoring, the need for intervention and the demand for liquidity, either system can dominate the other.

Another comparative analysis is proposed by John and Kedia (2000). They compare corporate governance systems within a framework varying according to two parameters: the cost of bank monitoring and the effectiveness of hostile takeovers. Thus, the optimal Governance mechanism could be either: (1) concentrated ownership (when bank monitoring is costly and takeovers are not a threat); (2) bank monitoring (when monitoring costs are low and takeovers are ineffective); or finally (3) dispersed ownership and hostile takeovers (when anti-takeover defences are low and monitoring is costly). One interesting implication arising from this model is that corporate governance systems outside USA or UK may not converge to the Anglo-Saxon model simply by introducing the same takeover regulations.

1.2.2 Empirical Evidence

Since shareholders rights can differ significantly across countries around the world and even across firms within the same country, it is extremely difficult to compare the actions and effects of large shareholders across countries or firms.

In general, large shareholder action is channelled through the board of directors, since large shareholders are in principle able to appoint board members representing their interests. When they have majority control of the board they can hire (or fire) management; furthermore, they can also exercise power by blocking the ratification of unfavourable decisions, or possibly by initiating decisions (Becht et al., 2003).

From a practice point of view, Corporate Law, corporate charters and securities regulations impose limits and constraints on these power, which vary significantly across countries. For example, rights like corporate voting and appointments to the board, which are a key issue in this dissertation, vary considerably across governance systems and corporate charters. In Germany, employees appoint 50% of the board members in large corporations (Prigge, 1998). In the UK, the listing requirements of the London Stock Exchange require large shareholders to keep an "arm's length" relationship with companies, limiting the right of blockholders to appoint directors to the board. In particular, a shareholder owning a stake equal or greater than 30% can appoint no more than 5 out of 12 directors; this requirement explains why the distribution of blockholdings tapers off abruptly at 30% (Becht et al., 2003).

Finally, according to the Dutch regulation, the corporate boards of larger companies must appoint themselves and their successors and some corporations issue special classes of shares having the sole right to nominate directors for election to the boards or to veto their removal (Becht et al., 2003).

Taking into account the fact this huge disparity among Governance regimes, a central question to be addressed emerges: does the presence of large investors or "relationship investing" improve corporate performance?

At least four generations of empirical studies have tested the proposition that there is a link between ownership dispersion, voting control and corporate (or financial) performance. The first generation of contributions was aimed to test the hypothesis that free-riding among dispersed ownership shareholders leads to inferior company performance. The results were mixed: while in the USA setting, many authors rejected the hypothesis that greater dispersion determines lower performances, it has been showed that owner-controlled firms significantly outperform manager-controlled companies in UK and that family control of corporation positively affects profitability in France (Gugler, 2001).

A major change in the empirical approach was stimulated by Demsetz and Lehn (1985) who suggested that ownership concentration is basically endogenous: some firms require large shareholder control while others tend do not. On the empirical field, the implication of this contribution means that, without accounting for this endogeneity, it is to be expected that a regression of firm performance on a control dummy in a cross-section of heterogeneous firms should produce no statistically significant relation if the observed ownership-performance combinations are efficient.

A second generation of contributions focuses on inside ownership by managers and considers the effects of takeovers threats. Stulz (1988) shows that the fraction α of the voting rights controlled by management is an important element of the ownership structure of publicly traded firms. He points out that the value of the firm is positively related to α for low values of α and negatively related to α as α becomes large. Although managers can change α by buying or selling shares, he shows that they can also do so through a variety of capital structure changes, through changes in corporate charter, and through the acquisition of shareholder clienteles favourable to management. Morck et al. (1988) present evidence on the relationship between cash-flow ownership

between 0% and 5%, and falls afterwards. One interpretation of these findings is that, consistent with the role of incentives in reducing agency costs, performance improves with higher manager and large shareholder ownership at first. However, as ownership gets beyond a certain point, the large owners gain nearly full control and are wealthy enough to prefer to use firms to generate private benefits of control that are not shared by minority shareholders. Thus there are costs associated with high ownership and entrenchment, as well as with exceptionally dispersed ownership.

The third generation continues to test the Stulz hypothesis but dramatically improves the econometrics, facing the endogeneity problem and showing reverse causation. The findings are mixed using instrumental variable and panel techniques, but as a general result the impact of corporate performance on managerial ownership seems not significant (Demsetz and Villalonga, 2001).

The fourth generation is more interested in two additional variables: the legal system and voting rights held in excess of cash-flow rights. These scholars cited in the first paragraph, find no effects for European countries (Faccio and Lang, 2002) and a negative effect of large investors in Asia (Claessens et al., 2000). Finally, La Porta et al. (1999) perform a Q-regression for 27 countries, but neither the cash-flow rights of controlling shareholders nor the legal system have a significant effect on corporate valuation.

1.2.3 Multiple Large Shareholders

Since the empirical content of the present work is to assess and evaluate voting trusts where two or more large shareholders share the control of the same firm, a brief summary of the contributions focused, in particular, on the interaction among multiple large shareholders (hereafter MLS) could prove useful.

The first model is the one proposed Pagano and Roël (1998) who consider a setting in which the manager in control is a large shareholder who is monitored by other large shareholders. In this case having two or more large shareholder monitoring the manager results in free-riding in monitoring but this free-riding enhances value because it reduces excessive monitoring by a very large shareholder. Thus, according to Pagano and Roël (1998), an ownership structure with several large shareholders is a

commitment device that allows shareholders to commit to an optimal monitoring intensity. The intuition behind this result is similar to that in Burkart, et al. (1997), where the reduction in the size of the ownership stake of the unique large shareholder reduces his incentives to monitor, thus preserving managerial initiative. As a general result, a trade-off between control and initiative emerges contingent on the outside ownership concentration.

Gomes and Novaes (2001), Bennedsen and Wolfenzon (2000) and Zwiebel (1992) consider a setting in which the firm is controlled by a group of large shareholders that hold the majority of the voting rights.

In Gomes and Novaes (2001) the controlling group, which is formed by all the large shareholders will only approve a project if all the members of the group benefit from the project. For a given ownership stake of the controlling group increasing the number of shareholders has two effects. The "bargaining effect", which implies that private benefit taking and rent extraction will be less likely, since all the members of the control group have to agree on the preferred project. And the "disagreement effect", which implies that the approval of positive net present value projects also becomes more difficult because of the necessary agreement of all the members of the controlling group. Also, for a given number of shareholders in the controlling group increasing the total ownership stake makes both effects stronger. The trade-off between the benefits from bargaining over private benefits and the costs of passing up profitable projects due to disagreements among the controlling shareholders, implies that there is an optimal number of large shareholders and an optimal size of the total controlling stake.

In Bennedsen and Wolfenzon (2000) the controlling group will not include all the large shareholders but will be the result of a coalition formation game where the different large shareholders form coalitions that compete to seize the control of the firm. Many different coalitions can have sufficient voting power to control the firm. Ex-ante the optimal coalition is the one with the largest ownership stake because of an "alignment effect". The greater the ownership stake of the controlling group the more the coalition internalizes the cost of dilution. However, ex-post, the preferred coalition will be the one with the smallest ownership stake necessary to win control. This is the "coalition formation effect": given that private benefits come at the expense of all the non-controlling shareholders, the coalition with the lowest possible ownership stake will

have the largest minority group whom to expropriate. This implies that it is optimal to have as few shareholders as possible. As the number of large shareholders increases, ownership rights are distributed among more shareholders and it is easier to form a controlling coalition with a low ownership stake.

In Zwiebel (1995) assumes that the control benefits will be divided among the different block-holders depending on the relative size of their respective blocks. Therefore if one block is much larger than the rest the probability that the small block-holders can share in the private benefits is reduced. In equilibrium the investors allocate their money across firms trying to maximize their benefits of control. Zwiebel shows that there will exist a threshold size beyond which the largest block-holder will not be challenged by other investors. Therefore in equilibrium there are two types of firms: firms with only one large block-holder, where the size of the block is beyond the threshold, and firms with several medium size blocks, where the size of the largest block is below the threshold.

Bloch and Hege (2001) present a model that considers both the monitoring and the minority expropriation problem arising from ownership structures with MLS. In their model there are two large shareholders that compete for control. The shareholders differ in their capacity to define the company's strategy and in their ability to monitor the manager. Only the shareholder who wins the control contest defines strategy but both shareholders perform a monitoring role. In order to win control the two large shareholders compete for the votes of the minority by committing to reduce their private benefits. The model is very rich and different equilibria can be attained depending on the heterogeneity in the monitoring costs and capacity to define strategy of the two competing shareholders.

To date, empirical evidence on the effect of MLS on firm performance has been limited. Lehman and Weigand (2000) report that the presence of a strong second largest shareholder enhances profitability in German listed companies.

Faccio et al. (2001) test the effect of MLS on dividends. They find that the presence of multiple large shareholders dampens expropriation in Europe (due to monitoring), but exacerbates it in Asia (due to collusion). For Italy, Volpin (2002) provides evidence that valuation is higher when control is to some extent contestable as in the case in which a voting syndicate controls the firm.

Finally, Maury and Pajuste (2003) using a sample of Finnish listed firms show that a more equal distribution of the votes among large blockholders has a positive effect on firm value. This result is particularly strong in family-controlled firms suggesting that families are more prone to private benefit extraction if they are not monitored by another strong blockholder. The authors argue that this relation significantly depends on the identity of these blockholders.

1.3 Private Benefits of Control

The previous two paragraphs of this chapter point out the fact that on the one hand, forms of concentrating ownership and thus large shareholders are much more common in corporations around the world than previously assumed by scholars. Since large shareholding come at cost (especially in terms of non-diversification), recent contributions in literature focused on what seems the main rationale of large shareholding, namely private benefits of control.

1.3.1 Searching for a Definition of Private Benefits of Control

One of the basic foundations of modern finance is diversification. The capital asset pricing model, just to take the most famous example, assumes that the investors will hold diversifiable risk. What motivates some investors to loose the benefits of diversification by concentrating much of their wealth in the shares of a single firm?

Large shareholdings seem to be motivated by two factors: the shared benefits of control and the private benefits of control.

Shared benefits of control are a consequence of the superior management or monitoring resulting from the substantial collocation of decisions rights and wealth effects implied by large shareholdings (Holderness, 2001). As the ownership stake of a shareholder increases, *ceteris paribus*, she has a greater incentive to increase firm value. To the extent that these higher cash-flows are shared with minority shareholders, they constitute shared benefits of control (Shleifer and Vishny, 1986).

On the other hand, the definition of private benefits of control is much more challenging. Anyway, a good starting point (as usual) could be a sentence by Adam

Smith (1776, Book II, Ch. 2) who made the distinction that a landlord's "*real wealth is in proportion, not to his gross, but to his net rent*", the difference mainly deriving from his "*private enjoyments and amusements*".

Jensen and Meckling (1976) proposed an up-dated definition which is at the base of the huge managerialist literature. They point out that owner-manager's benefits consist in "*benefits he derives from pecuniary returns but also the utility generated by various non-pecuniary aspects of his entrepreneurial activities such as the physical appointments of the office, the attractiveness of the office staff, the level of employee discipline, the kind and amount of charitable contributions, personal relations ("friendship," "respect," and so on) with employees, a larger than optimal computer to play with, or purchase of production inputs from friends*".

The two main aspects shared by those classical definitions are: (i) to a large extent, the non-pecuniary nature many private benefits have; and (ii) the derivation of these benefits from the assets ownership. Demsetz and Lehn (1985) identify as non-pecuniary benefits the "*amenity potential*" derived from owning sport teams or media companies "*winning the world-series*" and "*influencing public opinion*". Djankov et al. (2001), *inter alia*, offer a strong support to the hypothesis that "*the non-financial benefits, such as fame and influence, obtained by controlling a newspaper or a television station must be considerably higher than those from controlling a firm of comparable size in, say, the bottling industry*".

In their classical contribution, Grossmann and Hart (1998) focused on pecuniary gains in takeover bids, assuming a well-functioning market for corporate control. They define as private benefits the synergy gains realized by an acquirer, the ability to freeze out minority shareholders below market value, perquisites of control, and the diversion of resources. Within the control contests literature, Bebchuk and Kahan (1990) provide a definition of private benefits as "*any value captured by those controlling the company after the contest (and not shared among shareholders at large)*". They indicate as examples high salaries, self-dealing or looting, the power to tailor company policies to one's personal interests, and psychological utility from running the company. One of the latest definitions of private benefits is the one proposed by Coffee (2001) as "*all the ways in which those in control of a corporation can siphon off benefits to themselves that are not shared with other shareholders*", for example, above-market salaries, non-

pro-rata payments, self-dealing transactions, insider trading, and the issuance of shares at dilutive prices.

As described by Johnson et al. (2000), pecuniary private benefits stem from "*tunneling*" of minority shareholders with self-dealing transactions (asset sales and transfer pricing, excessive executive compensation, loan guarantees), or without asset transfers (dilutive share issues, insider trading, creeping acquisitions, minority discriminating transactions). The same type of private benefits Modigliani and Perotti (2000) have in mind when they talk about asset transfers at arbitrary prices, transfer investments at deflated prices, and sales of control blocks without equal treatment. In line with this interpretation Hanouna et al. (2001) differentiate between the "*egocentric drive to run an ever-larger enterprise*", the implementation of preferred management policies, and the ability to engage in self-dealing: excessive salary, looting, and squeeze-outs.

It is usually an unexplained assumption in the empirical literature that family ownership serves as a proxy for the existence of private benefits (Franks and Mayer (2001)). For example, Goergen and Renneboog (2001) argue that founder involvement in terms of managerial responsibility and voting stake is a proxy for private benefits. But in most cases it is not explained what these private benefits to the family really are. A rare exception is given by Holmén and Högfeldt (2000) who mention the high social prestige that Swedish families derive from "*running a firm with good reputation*", the ability to promote relatives and offspring, and the chance to "*do it my way*", all of which are not easily transferable to another owner, e.g., an acquiring firm.

However, since it is extremely difficult to find adequate empirical proxies for private benefits, most researchers like Field and Karpoff (2001) use only raw proxies like salary and bonuses.

Finally, in order to summarize the huge number of definitions of private benefits of control, it could be useful the taxonomy proposed by Ehrhardt and Nowak (2001) based on two dimensions: on one hand the pecuniary/non-pecuniary characteristic[10], and, on the other, the degree of transferability (both out of the company and to the

[10] Pecuniary private benefits of control are usually labeled as "tunneling" in the narrow sense of Johnson et al. (2001), i.e., the transfer of resources "out of firms to the benefit of those who control them". Most of the corporate control literature focuses just on these tunneling activities.

controlling shareholder(s) of a rival firm). By applying this taxonomy, the authors are able to cluster and define four distinct types of private benefits of control:

i. *Self-Dealing* transactions are "*pecuniary benefits that result directly from assets transfers out of the company into the pockets of those who control*" (Ehrhardt and Nowak, 2001); typical examples are excessive (above-market) compensation, diversion of corporate resources, assets transfers at arbitrary prices, cheap loans and guarantees;

ii. *Dilution* activities benefit the controlling shareholder(s) - without a direct transfer of assets - while determine a loss in the minority shareholders wealth; classical dilution activities are insider trading, creeping acquisition, freeze-out and squeeze-out and the issuance at dilutive prices;

iii. *Amenities* are represented by benefits non related with the pecuniary wealth of the controlling shareholder(s) but which are, at the same time, easily transferable to a new owner; examples are physical appointments, owning a luxury brand (e.g., "Ferrari" or "LVMH"), influencing public opinion owning a media company (e.g., "CNN" or "Corriere della Sera"), and - typical feature of the Italian business world – owning a sport company (let me say "Juventus");

iv. *Reputation* refers to the benefits not easily transferable to a new owner "because they take time to build, are owner-specific, and in many cases require family or at least geographical membership"; some examples are social prestige, family tradition, personal relations, and promotion of relatives (e.g., the dynastical link between Rothschild family and the homonymous bank, the relationship between FIAT and Agnelli family).

The above definition is probably the richest taxonomy of private benefits of control presented, to date, in the literature. Clearly much more work has to be done, both theoretically and empirically, in order to get a more exhaustive definition of private benefits of control.

A related (and highly debated) question is whether they necessarily harm minority shareholders. Holderness (2001) argues that synergy gains or non-pecuniary

"private benefits need not reduce the wealth of minority shareholders. This is an assumption of some analyses, but it is wrong". In contrast, other authors argue that the existence of *any* private benefit – whether pecuniary or non-pecuniary – which is not shared with the minority shareholders gives the controlling owner an incentive to deviate from the maximization of total firm value. Indeed, he will take decisions based on his will to maximize the sum of firm value and the value of her private benefits (Ehrhardt and Nowak, 2001). Jensen, for example, (2001) shows that "since it is logically impossible to maximize in more than one dimension, purposeful behaviour requires a single valued objective function". This view is also supported by Gilson (2003) who states that "the controlling shareholder's utility is affected by company decisions in ways other than through the decision's impact on the company's stock price. As a result, maximizing the controlling shareholder's utility may mean something other than maximizing the value of the corporation".

There is only a short step from defining to quantifying the private benefits of control. In spite of the importance of this concept, there are remarkably few attempts of estimating how big these private benefits are, even fewer attempts to document empirically what determines their size. Dyck and Zingales (2003) point out that "the lack of evidence is no accident. By their very nature private benefits of control are difficult to observe and even more difficult to quantify in a reliable way. A controlling party can appropriate value for himself only when this value is not verifiable (i.e., provable in court). If it were, it would be relatively easy for non-controlling shareholders to stop him from appropriating it. Thus, private benefits of control are intrinsically difficult to measure".

Nevertheless, there are two methods in literature, which will be discussed in next two paragraphs, to try to assess empirically the magnitude of private benefits of control.

1.3.2 Measuring Private Benefits of Control: the "Voting Premium" Method

The first method proposed in the finance literature for the measurement of private benefits of control relies on the existence of companies with multiple classes of stock traded which are characterized by different voting rights (*supra* § 1.1.2).

From a theoretical point of view, Zingales (1994) pioneered the linking of vote value to the extraction of private benefits by controlling shareholders. While a marginal

vote does not confer any control rights to a dispersed shareholder (due to coordination issues and asymmetric information), it becomes very valuable when it is pivotal, that is, when it is decisive in attributing to any of the management teams (large minority shareholders) fighting for it. Thus, the market value of a marginal vote at any time equals the expected discounted equilibrium value of a vote at the time of a control contest. As a consequence, vote value can be realized when the vote is sold to a shareholder for whom control carries a positive value[11]. That positive value of control translates, according to Zingales, into unique private benefits of control enjoyed by managers and/or large shareholders.

From an empirical point of view, this method is basically based on a sort of "decomposition" of the voting value. In general, the overall voting premium for company i at time t would be $VP_t^i = (P_{vt}^i - P_{nvt}^i)/P_{nvt}^i$, where P_{vt}^i and P_{nvt}^i are respectively the prices of voting and non-voting shares (Zingales, 1994).

Nenova (2003) improves this measurement technique transferring the focus from the value of a single vote (the voting premium), to the value of control-block votes in aggregate. The link between the two magnitudes can depend on the regulations in the market for corporate control, as well as on the general legal environment and firm-specific charter provisions. The author makes those factors explicit by taking into account several institutional, regulatory, and firm-level determinants of the value of control-block votes. The results demonstrate that differences in dividend payouts, liquidity, and other non-vote-related characteristics of the two classes of shares have a significant effect on the measurement of vote value and the failure to use proper controls can lead to relevant biases.

The findings of Nenova about the role of investor protection in seizing the magnitude of the voting premiums, receive further support from a recent study by Linciano (2002). This contribution explores, through a longitudinal study of voting premiums in Italy during the 1989-2000 period, the role of regulation improvements introduced by both the mandatory bid rule (Law 149/1992) and the 1998 Reform of Finance Regulation. While the former regulation change determined an 1,5% increase of the voting premium, the latter produced a 7% decrease. The author concludes that the

[11] Control here means the ownership of a sufficient voting power to take decisions on important company matters.

1998 Reform actually has resulted in a significant enhancement of investor protection in Italy, thus determining a substantial compression of private benefits of control extractable by controlling shareholders.

Finally, Nicodano (1998) adds an important piece to the voting premium puzzle in Italy. She points out that the creation of business groups, which is another way to deviate from the "one-share-one vote" principle, determines a larger voting premium in holding companies. Furthermore, the results imply that the voting premium in a holding company with the average portion of non-voting equity is much larger than the voting premium in an operating company without non-voting equity. Contrasting the findings by Zingales about "enormous" private benefits of control in Italy, the model proposed by Nicodano indicates that "normal" private benefits could be consistent with large premiums because of the multiplier effect of non-voting stock, pyramiding and the small portion of voting shares held by outsiders. The latter portion is relatively small when companies resort to pyramiding and dual-class shares because, as both theory and observation suggest, the controlling party keeps the majority of votes when it is allowed to separate cash flow rights from control rights.

1.3.3 Measuring Private Benefits of Control: the "Block Premium" Method

Barclay and Holderness (1989), in their pioneering contribution, were the first to offer systematic evidence of private benefits for large shareholders by studying the pricing of trades of large percentage blocks of common stocks. This methodological approach relies on the idea that if all shareholders receive corporate benefits in proportion to their fractional ownership, blocks should trade at the exchange price.

On the other hand, if large shareholders anticipate using their voting power to secure (private) benefits which are attached to the blocks they are going to acquire, then these blocks should trade at a premium to the exchange price. Furthermore, the premiums could be interpreted as approximations of the discounted value of the (net) private benefits. Conversely, if large-block shareholders expect to bear (net) private costs, then blocks should trade at a discount to the exchange price.

The main result in the article is that trades of large blocks of shares usually incorporate substantial premiums to the post-announcements exchange price (average

20%, median 16%). This result suggests that in most firms the net private benefits of large shareholders are positive.

Further investigation has been made by Barclay and Holderness through a cross-sectional regression analysis of the premiums. They found that, *ceteris paribus*, premiums tend to be larger as the magnitude of the block increases. This is consistent with the existence of private benefits of control: the larger the block, the larger the degree of control the block purchaser will realize. The authors also pointed out a positive relationship between firm performance (before the trade) and the size of the premium. This seems consistent with the private benefits, as more profitable firms are likely to offer greater private benefits (for example, more corporate funds available could gain larger salaries to hopefully blockholder-managers).

Subsequent studies confirmed that large block trades are generally priced at premiums to the exchange price, and these results are interpreted as approximating the anticipated private benefits of control (Mikkelson and Regassa, 1991; Chang and Myers, 1995).

The size of the private (as well as of the shared) benefits of control are likely to vary with certain firm or institutional environment characteristics.

On one hand, some authors underlined the role of *endogenous determinants* of private benefits and thus the level of ownership concentration. Most notably, the firm size should be inversely related to ownership concentration because both the wealth limitations and the risk aversion affecting potential large shareholder (Demsetz and Lehn, 1985; Holderness and Sheehan, 1988). Regulation, in particular, appears to affect the level of ownership because of the strict monitoring from regulatory agencies (Holderness et al., 1999).

On the other hand, in a recent article Dyck and Zingales (2003) focused on the comparative value of private benefits of control in 39 countries (totalling 412 control transactions) between 1990 and 2000. By applying the Barclay and Holderness (1989) method, they find that on average corporate control is worth 14% of the equity value of a firm (ranging from a -4% in Japan to a +65% in Brazil). This approach based on a cross-countries comparison enables the testing of *exogenous determinants* of private benefits. In particular, the main finding of the article is that the premium paid for

control is higher when the buyer comes from a country which is characterized by a poor investor protection, thus enabling the buyer to a larger extraction of private benefits.

The article offers strong evidence in support of some theoretical propositions about the effects private benefits of control have on the development of financial market across the world. Theory predicts that where private benefits of control are larger, entrepreneurs should be more reluctant to go public (Zingales, 1995b) and more likely to retain control when they actually do go public (Zingales, 1995b; Bebchuk, 1999). Furthermore, where private benefits of control are larger, a revenue maximizing Government should be more likely to sell a firm through a private sale than through a share offering (Zingales, 1995b).

These results corroborate the emphasis that since the milestone article by Shleifer and Vishny (1997) has been put, by both finance and law scholars, on the importance of protecting outside investors against expropriation by insiders. In particular, many institutional variables, taken in isolation, seem to be associated with a lower level of private benefits of control: better accounting standards, better legal enforcement, more intense product market competition, a high level of diffusion of the press, and finally a high rate of tax compliance.

Both the methods of measuring private benefits of control show some limits. In particular, the voting premium method is affected by at least three sources of weakness:

- The "endogeneity" problem arising from the fact that the decision to issue dual class stock is a company's choice, thus the samples available result self-selected and thus intrinsically biased;
- Since in many countries dual class shares are not allowed, the empirical analysis bears severe limits;
- A proper model is required in order to "decompose" the factors affecting the voting premium; apart from the problems attached to the quantification of the probability of a takeover or to the definition of a proper model of how private benefits will be shared among different parties, still many other issues should be take into account as it has been showed by both the papers by Nenova (2003) and Nicodano (1998).

Also the block premium method bears some weaknesses especially linked to the limited dimensions of samples adopted in cross-countries analyses (in Dyck and Zingales (2003), the quantification of private benefits for Italy is based on only 7 observations!) and to the lack of proper control variables as suggested by Nicodano and Sembenelli (2000). Moreover, the empirical evidence, to date, obtained by applying both the methods, does not take into account the role played by companies' industry (Massari and Zanetti, 2004). In particular, a further empirical investigation should address the measurement of private benefits of control in highly "sensitive" industries such as the media, entertainment (especially sport companies) and banking.

1.4 Who Controls Controlling Shareholders?

The previous paragraphs point out the fact that concentrated ownership and large shareholders are a common feature around the world, in Continental Europe and in Italy. Furthermore, some mechanisms of separating ownership and control are expected to exacerbate the expropriation of minority shareholders due to the extraction of private benefits of control. The question to be addressed in the following pages easily becomes whether the controlling shareholder system could be improved.

In the search for the "ideal owner", US corporations, even before the Enron collapse, seem not completely satisfied by the widely celebrated dispersed ownership system (Forestieri and Iannotta, 2003). A recent statement by Michael Porter casts doubts about the sustainability of the US corporate governance regime:

> *"Perhaps the most basic weaknesses in the American system is transient ownership, in which institutional agents are drawn to current earnings, unwilling to invest in understanding the fundamental prospects of companies, and unable and unwilling to work with companies to build long-term earning power...The natural instinct of many managers is to seek fragmented ownership to preserve their independence from owners in decision-making... The long-term interests of companies would be better served by having a smaller number of long-term or near-permanent owners, whose goals are better aligned with those of the corporation...Ideally , the controlling stake would be in the hands of a relatively few long-term owners...These long term owners would commit to maintaining ownership for an extended period, and to becoming fully informed about the company. In return for a long-term ownership commitment, however, must come a restructuring of the role of owners in governance. Long-term owners must have insider status, full access to information, influence with management and seats on the board...Under the new structure, management will be judged on the basis of its ability to build long-term competitive position and earning power, not current earnings of stock price."*

In order to evaluate "the role of owners in governance", we should first address a more basic question: what is corporate governance? The most effective answer probably is the one by Shleifer and Vishny (1997):

> *"Corporate Governance is, to a large extent, a set of mechanisms through which outside investors protect themselves against expropriation by the insiders"*[12].

Both the literature and the common wisdom agree in rejecting the idea that a "financing without Governance" – meaning a possibility of financing based exclusively on reputations of managers, or on excessively optimistic expectations of investors about the likelihood of getting their money back – could be sufficient in assuring investors (and creditors) that they get return on their financial investment. In contrast, the principal reason that investors provide external financing to firms is that they receive control rights in exchange. Thus, such diverse elements of countries' financial systems as the breadth and depth of their capital markets, the pace of new security issues, corporate ownership structures, dividend policies, and the efficiency of investment allocation appear to be explained, both conceptually and empirically, by how well the laws in these countries protect outside investors.

1.4.1 The Role of the Legal Environment and Investor Protection

When investors finance firms, they typically obtain certain rights or powers that are generally protected through the enforcement of regulations and laws. Some of these rights include disclosure and accounting rules, which provide investors with the information they need to exercise other rights. Protected shareholders rights include those to receive dividends, to vote for board directors, to participate in shareholders' meetings, to sue directors or the majority for suspected expropriation, to call extraordinary shareholders' meetings, etc. (Becht et al., 2003).

In different jurisdictions, rules protecting investors come from different sources, including company, security, bankruptcy, takeover and competitions laws (for Italy, see Marchetti, 1997), but also from stock exchange regulations and accounting standards. But, enforcement of law and regulations is as crucial as their contents. Italy is a clear

[12] The authors refer to both managers and controlling shareholders as "insiders".

example of bright laws - almost in line with the Continental European countries – which show weak (if any) enforcement effectiveness[13].

La Porta et al. (2000) examine the variation of legal rules and enforcement quality across countries and across "legal families". Extending some insights from legal scholars, they suggest, in particular that legal families play a key role in shaping the investor protection effectiveness in different countries. This argument is based on the fact that commercial legal systems around the world derive from relatively few legal families which include the English (common law), the French, and the German. In the 19th century, these systems spread across the globe "throughout conquest, colonization, and voluntary adoption". Thus, while the so-called Anglo-Saxon countries adopted the English common law systems, the French and German systems (which both derive from Roman law) took Continental Europe, Latin America and some East Asian countries. Then, La Porta et al. (2000) show that common law countries have the strongest protection of outside investors (both shareholders and creditors), while the French civil law countries have the weakest protection.

Johnson et al. (2000) propose a "judicial" explanation of why common law protects investors better than civil law. They explain that legal rules in the common law system are usually made by judges, based on precedents and inspired by general principles such as "fiduciary duty" or fairness. In contrast with the civil law system, in common law countries judges can rule on new situations by applying these general principles even when that specific crime or misconduct is not (or not yet) explicitly described or prohibited in the code. In cases of minority shareholders' expropriation (usually called self-dealing), the judges "try to sniff out whether even unprecedented conduct by the insiders is unfair to outside investors". On the contrary, in civil law systems judges are not expected to go beyond what is explicitly stated by the code, and if corporate insiders find the way of expropriating outside investors without incurring in situations explicitly prohibited in the code, they should avoid an adverse judicial ruling.

As a general result, different degrees of investor protection have a number of implications for the ownership structure of firms. The most basic of these implications

[13] This argument is in contrast with the traditional "law and economics" perspective on financial contracting. According to this stream of literature, regulation is mainly unnecessary since contracts take

is the concentration of control rights in firms (which, as we have shown in § 1.1.2, could diverge significantly from cash-flow rights). When investors' rights are poorly protected, then expropriation could be substantial and the private benefits of control become a relevant fraction of the firm's value.

Bebchuk (1999) develops a rent-protection theory of corporate ownership structure - and in particular, of the choice between concentrated and dispersed ownership of corporate shares and votes. The paper analyzes the decision of a company's initial owner whether to maintain a lock on control when the company goes public. This decision is shown to be very much influenced by the size that private benefits of control are expected to have. Most importantly, when private benefits of control are large - and when control is thus valuable enough - leaving control up for grabs would attract attempts by rivals to grab control and thereby capture these private benefits; in such circumstances, to preclude a control grab, the initial owner might decide to maintain a lock on control.

Furthermore, Bebchuk points out that when private benefits of control are large, maintaining a lock on control would enable the company's initial shareholders to capture a larger fraction of the surplus from value-producing transfers of control. Both results suggest that, in countries in which private benefits of control are large, publicly traded companies will tend to have a controlling shareholder. It is also shown that separation of cash flow rights and voting rights will tend to be used in conjunction with a controlling shareholder structure but not with a dispersed ownership structure. The analysis also implies that a corporate law system that effectively limits private benefits of control can produce more efficient choices of ownership structure.

In sum, the evidence (*supra* § 1.1.1) has proved to be broadly consistent with the proposition that the legal environment shapes the value of the private benefits of control and thereby determines the equilibrium ownership structure (La Porta et al., 2000). Then, in large corporations of most countries, the fundamental agency problem is not the conflict *à la Berle and Means* between outside investors and managers, but rather the one between outside investors and controlling shareholders who have nearly full control over the managers.

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place between issuers and investors which knowingly converge toward efficient solutions, punishing

The above analysis of the ways investor protection affects the ownership structure at a micro-level, generates some consequences also at aggregate level shaping the development of financial markets across the countries. In that perspective, the most basic prediction of the legal approach is that when investors are well protected from expropriation, they pay more for securities, making it more attractive for entrepreneurs to issue these securities. This applies to both creditors and shareholders. Thus, creditor rights encourage the development of lending, and the exact structure of these rights may alternatively favour bank lending or market lending. Shareholder rights encourage the development of equity markets, as measured by the valuation of firms, the number of listed firms (market breadth), and the rate at which firms go public. For both shareholders and creditors, protection includes not only the rights written into the laws and regulations but also the effectiveness of their enforcement. Consistent with these predictions, La Porta et al. (1997) show that countries that protect shareholders have more valuable stock markets, larger numbers of listed securities per capita, and a higher rate of IPO (initial public offering) activity than do the unprotective countries[14].

1.4.2 Research and Policy Implications

The previous paragraph summarized the main points of the dominant "law and finance" theory, which stresses the importance of legal protection of investors for the development of capital markets, arguing that legal protection is "ultimately a by-product of the country's legal origin".

A competitive major theory offering an alternative explanation of the determinants of financial development, is the "political economy" approach which posits that financial development is just the outcome of political decisions. This theory is much more dynamic in nature, since it assumes an evolutionary perspective due to the fact that changes of political powers of different constituencies evolve, across the time in each country, affecting the disposition of a country towards financial development. As with any political decision, financial development is the outcome of ideology and

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issuers that fail to disclose (within the contracts) information about themselves.

[14] The implied consequence of these findings is that the legal approach is a more fruitful way to understand corporate governance and its reform than the conventional distinction between bank-centered and market-centered financial systems.

the economic interests of voters and pressure groups. Rajan and Zingales (2003) argue that the stock market can be fostered or hampered by government action depend upon the balance of powers between pressure groups. Pagano and Volpin (2001) and Bias and Perotti (2002) argue that state intervention in the economy should be negatively correlated with financial development, because the state acts as a substitute for financial markets. Finally, Perotti and Volpin (2004) suggest that incumbent families may lobby the government to keep financial markets underdeveloped to preserve their power by preventing entry by potential competitors.

One of the predictions emerging from the "political economy" view is that ownership should be more concentrated and companies should be organized into groups in countries where the government has a big role in the economy. The intuition is in Pagano and Volpin (2001). When the state has a great involvement in the economy, firms need political support to grow. Hence, to maximize their political clout, businessmen need to maximize the value of assets under their control. With concentrated ownership and pyramidal groups, both goals are attained[15].

An interesting example of the "political economy" approach is the paper by Aganin and Voplin (2003), which covers all companies traded on the Milan stock exchange during the Twentieth century, in order to study the evolution of the stock market, the dynamics of the ownership structure of traded firms, the birth of pyramidal groups, and the growth and decline of families in Italy. In particular, they find that the stock market evolved over time according to a non-monotonic pattern, with a more developed stock market at the beginning of the century than at the middle. Similarly, ownership structure was more diffused in 1940s than in 1980s. Moreover, family controlled groups and pyramids were less common in 1930s than in 1980s. These findings are inconsistent with the view that stock market development and ownership concentration are monotonically related with investor protection. On the contrary, the relationship between politics and economic actors give a more convincing explanation of the evolutionary role assumed by external finance of Italian corporations.

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[15] On the contrary, if the government has a more limited involvement in the economy, political connections are less important. As a consequence, pyramidal groups and concentrated ownership are less diffuse.

Clearly, the two leading theories described above are not necessarily alternative, but both of them contribute to comprehension of the "financial development" puzzle adding important explanatory insights.

From the point of view of policy implications arising from the comparative analysis of corporate governance regimes around the world, scholars are focusing on the obstacles against an actual improvement of investor protection. Gilson (2000) distinguishes between legal and functional convergence. The former refers to changes in rules and enforcement mechanisms toward some successful standard (that tacitly is assumed to be the US's one). This kind of changes, in certain sense, comes from the top and relies on extensive legal, regulatory and judicial reform. On the contrary, the functional convergence comes from the bottom in the sense that it relies on the market forces which should progressively bring more firms under the protection of more effective governance systems.

In particular, since for most countries the improvement of investor protection requires radical changes in the legal system, the political opposition to such change has often proved intense. La Porta et al. (2000) point out that:

> *"Governments are often reluctant to introduce laws that surrender to the financiers the regulatory control they currently have over large corporations. Important objections to reform also come from the families that control large corporations. From the point of view of these families, an improvement in the rights of outside investors is first and foremost a reduction in the value of control due to the deterioration of expropriation opportunities. The total value of these firms may increase as a result of legal reform, as expropriation declines and investors finance new projects on more attractive terms; still, the first order effect is a tax on the insiders for the benefit of minority shareholders and creditors. What the reformers see as protection of investors, the founding families call "expropriation of entrepreneurs". No wonder, then, that in all countries - from Latin America to Asia to Europe - the families have opposed legal reform".*

Today, the discussion about reforming corporate governance is intensifying around the world. Just in these months, many investor protection's items are on the regulators agenda both in the (post-Enron) US and (post-Parmalat) Italy. While, for example, the recent SEC's shareholder access proposal has attracted a hated debate among both managers and scholars (Bebchuk, 2004), the so called "Decreto sul Risparmio" is a hot issue on the Italian political agenda.

One of the straightforward implications of the literature streams presented in this chapter, is the central role of controlling shareholders in shaping efficient corporate

governance mechanisms. Since, as we noted before, the Italian regulatory framework is purported to be an inefficient one from the point of view of private benefits of control extraction, then a deeper understanding of the Italian controlling shareholders' system is needed in order to both identify and eliminate such distortions. According to Gilson (2003), an inefficient system can be especially attacked directly by improving the legal system to constrain pecuniary private benefits of control to levels that, net of these costs, leave minority shareholders better off as a result of focused monitoring. This kind of legal improvement typically means ameliorating the regulation of the following issues: (i) the statement of the standards that make significant pecuniary private benefits of control unlawful; (ii) the disclosure process that allows pecuniary private benefits of control to be observed by those who have the power to enforce the legal standard; and remarkably (iii) the available public and private enforcement mechanisms available.

The 1998 Reforms has been a positive step in the desirable direction of improving investor protection in Italy, but still the effective enforcement of these provisions represents a wide structural deficiency of the Italian system.

As a general conclusion of this chapter, we would like to cite some remarks by Gilson (2003) who stresses the centrality the large shareholders' theme is assuming within the Corporate Governance literature attracting both finance and law scholars, and thus stimulating the research effort of this dissertation:

> *"Our charge today is to look ahead to the next ten years. What issues will command our attention going forward? What should drive our agenda for the next decade? [...] I believe, with the confidence that comes from having a great deal of company, that we are going to stop spending so much time on understanding the role of hostile takeovers, which remain largely a phenomenon of the United States and United Kingdom capital markets because only in those two jurisdictions is control of most public companies in the public float. Rather, I not so boldly predict that scholarship and policy debate will complete a shift whose beginnings are already visible in both venues. Attention will increasingly center on understanding the kind of control structure that dominates public corporations everywhere in the world other than the U.S. and the U.K and which the Thirteenth Directive, as adopted, will not itself dissipate: a shareholder or group of shareholders with effective voting control, often but not invariably without corresponding equity holdings".*

2 *Voting Trusts as Mechanisms of Separating Ownership and Control: An Empirical Investigation*

"Le azioni si pesano, non si contano"

ENRICO CUCCIA[16]

2.1 Italian Voting Trusts as a Research Field

The first chapter of this dissertation presents a brief (and far from complete) overview on the literature focused on the role of large shareholders within ownership structure of corporations around the world. One of the most promising arena of this growing literature stream, is the further development of both theoretical models describing the interactions among large shareholders and (especially) more robust empirical analyses of the ways multiple large shareholders actually share the control of corporations. In that perspective, Italian "*Patti di Sindacato*" represent a unique opportunity of studying, empirically, the sharing of control as a corporate governance mechanism.

Hereafter, we will use the expression voting trusts to define Italian "Patti di Sindacato" but these do not exactly correspond to the "original" Anglo-Saxon voting trust[17]. Actually, the definition of voting trust, within the Anglo-Saxon setting, is the following: "a trust which solicits vote proxies of shareholders of a corporation to elect a board of directors and vote on other matters at a shareholders' meeting. A voting trust is usually operated by current directors to insure continued control, but occasionally a

[16] Attributed to.

[17] In the international literature, Italian "Patti di Sindacato" have been originally called voting trusts by Zingales (1994) and later by La Porta et al. (1998). More recently, Volpin (2002) adopts the label "voting syndicates". Anyway, we adopt the former translation.

voting trust represents a person or group trying to gain control of the corporation"[18]. This definition highlights the fact that voting trusts are usually created in order to combine the voting power of shareholders through the transference of legal title and voting rights to a designated trustee for a set duration. While, the rationale of Italian "Patti di Sindacato" resembles the one of Anglo-Saxon voting trusts, on a technical basis they show some significant differences.

The key difference relies in the fact that Italian voting trusts are basically shareholders agreements who sometimes establish the setting-up of *ad hoc* supervisory committees or organs (namely, "Assemblea del Patto", "Direttivo del Patto", "Presidenza del Patto"), while voting trusts in Anglo-Saxon setting generally refer to more complex structures which are based on the "physical" transfer of shares.

In particular, the "general plan" of a US voting trust is controlled by the voting trust agreement, and accordingly the shareholders endorse their stock certificates to the voting trustee. The voting trustee surrenders these certificates to the corporation receiving in return new certificates issued in its name; as a consequence, the voting trustee votes the shares as principal, rather than as agent as in the case of proxies.

Thus, the trustee holds the stock solely for the purpose of exercising any voting rights as provided by the instrument of trust or as the parties to the agreement might agree, and the shareholders continue to receive all dividends and other corporate actions (beneficial ownership).

Despite the common wisdom, the origins of Italian voting trusts can be traced at the beginning of the Twentieth Century[19] and many legal issues about them remain, after a century, still highly debated:

> *"I patti di sindacato sono al centro di accesi dibattiti da molti anni e in molti Paesi e, quando un problema che li riguarda sembra ormai superato, si affacciano nuovi interrogativi sui quali riprende la discussione. [...] I motivi di tante incertezze sono diversi, innanzitutto la "potenza" dello strumento che ne permette svariati usi, molti dei quali attengono agli assetti proprietari di società grandissime e quindi possono rientrare nelle complesse partite giocate intorno agli equilibri del potere economico di un Paese. All'incandescenza del tema dovuta ai sottostanti interessi economici e ai conseguenti scontri politici, si aggiungono, poi, le incertezze giuridiche causate dalla complessità del tema che coinvolgendo vari argomenti, richiede oltre a conoscenze assai vaste, la conciliazione tra interessi di natura diversi"*[20].

[18] Cfr. *Investopedia*.
[19] Cfr. A. Sciabola, "Nullità degli accordi vincolanti la libertà di voto nelle assemblee sociali", in *Foro Italiano*, 1 (1912), c. 181.
[20] From *I Patti Parasociali*, Quaderno del Giornale dei Dottori Commercialisti, 1 (1999).

Italian voting trusts can be divided into two main groups: "*sindacati di voto*" and "*sindacati di blocco*". The former relies on agreements which bind the members of the trust to vote in a certain d vote within shareholders' meetings and/or within corporate board's meetings. The content of this kind of trust varies widely ranging from the agreement on voting together a single specific issue to more complex agreements where the members statue the decisional criteria (i.e. *per capita*, unanimously, super-majority) and mechanisms which determine how the members of the trust should vote on relevant corporate issues.

The latter kind of trust is based on constraints about the selling of shareholdings owned by trust's members. Also in this case the content of the agreements can be declined in various ways from the simple prohibition of the selling to the articulation of *pre-emption-rights* among the trust members. Usually voting trusts which combine provisions of both types are termed "*patti globali*". Table I shows the adoption rate of those voting trust typologies by Italian listed companies, emerging from CONSOB data.

Table I: Evolution of Voting Trusts Controlling Italian Listed Companies

Year	Number of Voting Trusts' Agreements			Number of Companies		
	"Blocco"	"Voto"	"Globale"	"Blocco"	"Voto"	"Globale"
2003	14	11	40	14	9	38
2002	13	11	47	13	11	43
2001	56	14	68	26	9	58
2000				12	7	44
1999				11	8	51
1998				11	7	47
1997				16	10	57

Shareholders' agreements specifying the rights and duties of trust members usually contain the following articles:

- *Pre-emption rights* ("Diritto di prelazione") that confer precedence to the parties in buying other members' stakes at "fair" value in case syndicated shareholders should wish to exit the trust;
- *Provisions of control* which consist in the explicit designation of the rights and duties of the trust's members in the management of the company, and

requirements of prior unanimous or majority consent (in the case of "*patti di consultazione*" a simple consultation among trust's members is required) for relevant decisions such as the declaration of any dividend, the approval of business plans or M&A transactions, the disposal of corporate assets, the issuance of shares, etc.;

- *Restrictions on the transfer of shares* (clause usually adopted in "*Patti di blocco*") when the shareholders commit not to sell, pledge, or charge their shares except with the prior written consent of all other trust's members[21];
- *Right of first refusal:* a shareholder offered to sell her shares to an outside investor at some price is required to offer his shares to the other shareholders at the same price. If the other shareholders decline, the first shareholder is free to sell her shares to the outside investor;
- *Election of directors/"Collegio Sindacale" members*: explicit agreement on the number, role (i.e., Chairman and Vice-chairman of the board of directors) and board seats allocation among trust's members;
- *Call/put options* when trust's members are granted put options on the shares, in part or in whole, held by the other members, at a strike price that is typically equal to "fair" value (the reverse in the case of call options);
- *Valuation*: the 'fair' value of the shares is generally determined by an external expert (usually an investment bank), or it is based on a previously agreed valuation formula;
- *Drag-along rights*: in case a trust's member sells his stake to an outside investor, drag-along rights grant the investor the right to buy out the other members' stakes at the same price and on the same terms as the first shareholder's stake;
- *Tag-along rights*[22] ("Diritto di co-vendita"): in case a trust's member sells his stake to an outside investor, tag-along rights grant the other members the right to require the outside investor to buy their stakes at the same price and on the same terms as the first shareholder's stake. Tag-along rights can be viewed as conditional put options granted all shareholders;

[21] The rationale of this kind of agreements relies on the fact that a coalition of controlling shareholders could try to exclude one or more members of the controlling group from the firm's decisions. These restrictions can avoid ex-post incentives

[22] Also known as *co-sale agreements*, or *piggy-back rights*.

- *Dispute resolution and arbitration*: The shareholders agree to follow a specified procedure to resolve disputes. The procedure may specify the appointment of an arbitrator.

From a pure juridical point of view, the rationale of voting trusts consists in introducing some personalisation elements within the ownership structures of corporations. While, in general, listed companies' shares are created equal and are perfectly interchangeable, the identity of the owners of shares gathered within matters. In this sense, voting trusts restore the "*intuitus personae*" overcoming the mere "*intuitus pecuniae*" reflected in corporate charters. Libonati (1987) points out that:

> *"il ricorso alla fonte contrattuale (e non statutaria) è dovuto appunto alla necessità di ripescare i soci-persone in un contesto, quello statutario, che vede i soci solo come portatori di azioni, tipicamente fungibili".*

Both scholars and jurisprudence showed an unfavourable attitude toward voting trusts in consideration of the ambiguous effects they often generated especially in terms of both incompatibility with corporate charters and enforceability toward the trust's members. Rossi (2003) roughly explains:

> *"questi organismi servono in realtà a concentrare il controllo delle società quotate, e così aggirano il principio fondamentale dei mercati finanziai, in base al quale il rapporto fra controllo e investimento nel capitale di rischio deve rispondere a un criterio di proporzionalità. Quando però si riducono a questo, i sindacati azionari generano dasè gravi conflitti di interesse, e spingono chi li sottoscrive a comportamenti opportunistici. Sindacati e patti parasociali hanno insomma una finalità sostanzialmente contraria, o quantomeno parallela, alla struttura tipica e legittima delle società di capitali ".*

Indeed, finally the 1998 Reform has shown a breakthrough approach toward this problem acknowledging the role of voting trusts within the ownership structure of Italian companies:

> *"se ancora una volta non è stata scritta la parola definitiva sui sindacati di voto, considerando il Testo Unico insieme alle altre norme che si riferiscono ai sindacati e alla giurisprudenza, non si può non concludere che sui sindacati vi sia ormai se non un riconoscimento completo, senza dubbio un orientamento favorevole".*

In particular, the Articles 122 and 123 of the 1998 *Consolidated Law on Finance*[23] regulate the shareholders agreements, in whatsoever form concluded, whose object is the exercise of voting rights in companies with listed shares or companies that control them. Moreover, the article explicitly applies to agreements that:

a) create obligations of consultation prior to the exercise of voting rights in companies with listed shares or companies that control them;
b) set limits on the transfer of the related shares or of financial instruments that entitle holders to buy or subscribe for them;
c) provide for the purchase of shares or financial instruments referred to in subparagraph b);
d) have as their object or effect the exercise, jointly or otherwise, of a dominant influence on such companies.

The 123 Article regulates the Duration of agreements and right of withdrawal. It establishes that if agreements have fixed term, they may not have a duration greater than three years and shall be deemed to have been concluded for such duration even if the parties provided for a longer term; agreements shall be renewable upon expiry. Agreements may also be concluded for an indeterminate period; in such case each party may withdraw on giving six months' notice.

Shareholders who intend to accept a public offer to buy or exchange may withdraw from the agreements without notice. However, the declaration of withdrawal shall not produce effects if the transfer of the shares has not been finalized.

There is an other Article of the *Consolidated Law on Finance* which is relevant in terms of voting trusts' regulation. That is the Article 109, which regulates concerted acquisitions[24], establishes that participants in an agreement (regardless of whether it is null and void) referred to in Article 122, shall be jointly and severally subject to the obligations of making a public offer where they come to own, as a result of purchases for a consideration made by one or more of them, a combined shareholding exceeding the percentages specified in the articles 106 and 108 of the *Consolidated Law on*

[23] That is the *Legislative Decree 58 of 24 February 1998, Consolidated Law on Finance pursuant to Articles 8 and 21 of Law 52 of 6 February 1996.*

Finance[25]. Furthermore, the obligation to make a public offer shall also apply where the purchases were made in the twelve months preceding the conclusion of the agreement or at the same time as it was concluded.

The regulation of voting trusts underlies their key role in securing the control of corporations, and thus in shaping the market for corporate control. Both legal scholars and the financial community acknowledge that (Giornale dei Dottori Commercialisti, 1999):

> *"Il motivo principale per cui si stipulano patti di sindacato è certamente la possibilità di esercitare un'influenza dominante nell'assemblea della società e quindi la possibilità di esprimere i suoi amministratori e attraverso di essi decidere la strategia della società. In effetti nelle grandi società per azioni è difficile che un solo socio abbia le disponibilità finanziarie per possedere un pacchetto di azioni idoneo a dargli il controllo né è detto che anche avendo tali disponibilità voglia impegnarle tutte in un'unica società. Tuttavia se più soci coordinano il proprio voto possono far prevedere in assemblea la propria decisione circa una delibera. Il problema è realizzare tale coordinamento nell'esercizio del voto prima di prendere una decisione comune. A tale scopo viene appunto stipulato un sindacato di voto, un contratto parasociale con cui i soci si vincolano ad esercitare il voto deciso in seno al sindacato".*

While the anecdotal wisdom about the rationale of Italian voting trusts seems robust, as far as we know, to date, no empirical study has explored the sharing of rights among trusts' members.

2.2 Data and Methodology

This analysis in based on the database of shareholders' agreement held by CONSOB in accordance with the *Consolidated Law on Finance*. Hence, according the articles 127-130 of the CONSOB Regulation 11971/1999, an extract summing up the main contents of shareholders' agreements shall be sent to CONSOB (the disclosure rules about shareholders' agreements are further described in the paragraph 3.1.1). In particular, the extract shall contain the information needed for a thorough assessment of the agreement and at least the following:

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[24] This regulation resembles the "*acting in concert*" provision of the UK *City Code on Takeovers and Mergers* (Marchetti and Bianchi, 1999).

[25] That are 30% (*Complete-acquisition public offers*) and 90% (*Residual-acquisition public offers*) respectively.

a) *the name of the company whose shares are the subject of the agreement;*
b) *the number of shares and financial instruments giving the right to buy or subscribe for shares contributed overall, their percentage ratio to the total number of shares and financial instruments issued of the same class and, in the case of financial instruments, the total number of shares that can be bought or subscribed for;*
c) *the names of the persons participating in the agreement*[26]*, specifying:*

- the number of shares or financial instruments giving the right to buy or subscribe for shares contributed by each participant;

- the percentage of shares contributed by each participant in relation to the total number of shares contributed and to the total number of shares of the same class in the capital; where the subject of the agreement consists of financial instruments giving the right to buy or subscribe for shares, the percentage of the instruments contributed by each participant in relation to the total number of instruments contributed and to the total number of instruments issued of the same class and the number of shares that can be bought or subscribed for.

- the name of the person who controls the company as a consequence of the agreement.

d) *the content and duration of the agreement;*
e) *the office of the Company Register where the agreement is filed and, where they are already known, the date and details of the filing.*

Those information shall be supplemented by the following elements where they are referred to in the agreement:

a) *the type of agreement among those referred to in Article 122.5 of the Consolidated Law;*
b) *the organs of the agreement, the tasks entrusted to them and their composition and operation;*
c) *the rules governing the renewal of the agreement and withdrawal therefrom;*
d) *penalty clauses;*
e) *the person with whom the financial instruments are deposited.*

The on-line dataset containing the extracts of shareholders' agreement related to Italian listed companies (or unlisted companies which control them) is public, thus the

[26] Where agreements are in the form of an association or are among more than fifty persons, the information on participants with a holding of not more than 0.1% may be replaced by the specification of the total number of such persons, the total number of shares contributed by them, and the percentages thereof in relation to the above-mentioned parameters. Within seven days of the publication of the notice convening the company's annual general meeting, an up-to-date list shall be sent to the company with the names of all the participants and the number of shares contributed by each one. The list shall be made available by the company for consultation by the public.

identity of voting trusts members, their shareholdings and the contractual provisions included in the agreements can be easily traced.

The analysis covers the extracts during a six-years period from 1998 to 2003. From the set of all extracts, we selected exclusively the extracts related to voting trusts ("*patti di voto*", "*patti di blocco*" or "*patti globali*"). Due to the relatively small dimension of the sample, and since during the covered period many voting trusts changed their composition and/or the contractual provisions, we choose to include in the dataset only a single voting trust agreement (that is the most recent) for each company. Hence the final sample contains 74 companies (59 industrial corporation and 15 financial institutions).

In order to determine the ultimate ownership of the stakes held in voting trusts, we follow the method pioneered by La Porta et al. (1999) based on a definition of ownership relying on voting rights rather than cash-flow rights. We divide the observations into those that are widely held and those with ultimate owners. The latter have been classified into three categories according to the information available on the ultimate owners of stakes held by voting trusts' members. An ultimate owner is classified as "foreign-controlled" if it is a foreign company or institution; is defined "State & Foundations-controlled" if the ultimate owner is the State, a government agency, a local government entity or a foundation. If one or more private Italian citizens or an Italian family is the ultimate owner, then that is labelled "Family-controlled".

Finally, we say that the stake included in a voting trust is "Widely-held" if the entity at the top of the control chain has no single shareholder exceeding the 20% cut-off level (La Porta et al., 1999; .Claessens et al., 2000; Faccio and Lang, 2002; Volpin, 2002).

According to the basic definition, cash-flow rights are the fraction of a portfolio company's equity value that different shareholders have a claim to (Kaplan and Stromberg, 2002). However, the definition of cash-flow rights adopted in this work differs substantially from the one commonly used in the ownership structure literature. Since the objective of this work is the assessment of the separation between ownership and control obtained through voting trusts, we do not take into consideration the effect of pyramiding in the separation between cash-flow rights and voting rights. This means

that we consider "gross" cash-flow rights (while "net" cash-flow rights are the product of the fractions of cash-flow rights held at each level of the pyramidal structure) assuming that the owners of the shareholdings do not pyramid.

The rights to control or make corporate decisions are provided in board rights and in voting rights. The former are defined, following Kaplan and Stromberg (2003), as the number of seats that are reserved or controlled by each shareholder. Even if listed companies generally elect a certain number of independent directors[27], we do include in our analysis seats explicitly reserved to independent directors who are appointed by a certain trust's member[28]. The board is generally responsible for (i) hiring, evaluating, and firing top management; and (ii) advising and ratifying general corporate strategies and decisions. Certain corporate actions are governed or subject to shareholder votes. These vary across firms, but generally include large acquisitions, asset sales, subsequent financings, election of directors, or any other actions included in corporate charters.

We do not provide any analysis on the election of *Collegio Sindacale* members. Voting trust's members often agree on the distribution of rights of appointing the members of that organ, but within the Italian setting the effectiveness, and thus the

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[27] The directors' independence, according to the *Codice di Autodisciplina*, is granted if they: "*a) do not entertain, directly or indirectly or on behalf of third parties, nor have recently entertained business relationships with the company, its subsidiaries, the executive directors or the shareholder or group of shareholders who controls the company of a significance able to influence their autonomous judgement; b) neither own, directly or indirectly or on behalf of third parties, a quantity of shares enabling them to control the company or exercise a considerable influence over it nor participate in shareholders' agreements to control the company; c) are not immediate family members of executive directors of the company or of persons in the situations referred to in points a) and b)*".

[28] Both scholars and commentators cast doubts about the effective validity of the "independence" status for directors. Citing a recent article (by M. Liera, *IlSole24Ore*, January 24, 2004): "*Stare nei consigli significa entrare a far parte di network importanti: non sono gli emolumenti che contano, quanto l'indotto che un professionista può ottenere grazie alla carica occupata. E anche qui non si tratta solo di incarichi della stessa società (tra l'altro vietati agli indipendenti), quanto di quelli ottenuti indirettamente dai suoi clienti, fornitori o dagli altri consiglieri*".
Furthermore, many scholars view regulations about independent directors with much scepticism (Becht, et al., 2003): "*Most regulatory efforts have concentrated on the issue of independence of the board. In an attempt to reduce the CEO's influence over the board many countries have introduced requirements that a minimum fraction of the board be composed of so-called 'independent' directors. The rationale behind these regulations is that if directors are not otherwise dependent on the CEO they are more likely to defend shareholders' interests. It is not difficult to find flaws in this logic. For one thing, directors who are unrelated to the firm may lack the knowledge or information to be effective monitors. For another, independent directors are still dependent on the CEO for reappointment. Perhaps the biggest flaw in this perspective is that it does not apply well to concentrated ownership structures. When a large controlling shareholder is in place what may be called for is not only independence from the CEO, but also independence from the controlling shareholder. In corporations with concentrated ownership independent directors must protect the interests of minority shareholders against both the CEO's and the blockholder's actions*".

relevance, of this organ seems limited in both corporations and financial institutions (Viganò, 2000).

Finally, we study the separation of control and management, in companies controlled by a voting trust where the largest shareholder is a family, by investigating whether a member of the family is the CEO, chairman, honorary chairman or vice-chairman of the company.

2.3 Results and Discussion

The first issue addressed in the analysis is the measurement of the number of voting trusts' members as shown in Table II. We divide the 74 firms in the sample into 27 *Blue-Chips* (companies whose market valuation is above 800 Million Euro) and 47 *Small-Middle Capitalization* companies.

The average number of voting trust's components is equal to 22,66 for the former group and to 5,91 for the latter. However, the Blue-Chips result is biased by the presence of two outliers, namely Banca Lombarda and Hera, which are held by voting trusts composed by respectively 321 and 131 ultimate shareholders. Thus, the difference between the two groups is not statistically significant (t = 1,34).

Table II: Number of Voting Trusts' Members

	Obs.	Mean	Median	Std. Dev.	Min	Max
Blue-Chips	*27*	22,66	5,00	64,48	2,00	321,00
Small-Mid Cap.	*47*	5,91	4,00	5,60	2,00	27,00
Total Sample	*74*	12,03	4,00	39,58	2,00	321,00
		Test of Means (t-statistic)				
Blue-Chips vs. Small-Mid Cap.		1,34				

The second question addressed consists in the identification of the ultimate owners of shareholdings held in voting trusts. By applying the methodology described in the previous chapter, we are able to trace the chain of controls determining the average values represented in Table III.

Table III: Average Stakes in Voting Trusts' Shareholdings (20% cutoff)

	Obs.	*Ultimate Owner*			
		Families	State & Foundations	Foreign	Widely-held
Blue-Chips	*27*	*47,81%*	*18,33%*	*15,30%*	*18,67%*
Small-Mid Cap.	*47*	*78,83%*	*5,13%*	*11,55%*	*6,64%*
Total Sample	*74*	67,48%	9,94%	12,92%	11,01%
		Test of Means (*t*-statistic)			
Blue-Chips vs. Small-Mid Cap.		-3,73	2,31	0,66	2,38

The data confirm the overwhelming role played by family-ownership (average 67,48%) followed by foreign investors (12,92%) widely-held firms (11,01%) and the State & foundations (9,94%)[29]. From the comparison between Blue-Chip versus Small-Mid Cap companies, some interesting differences emerge. The weight of family is lesser in voting trusts controlling largest companies (t = - 3,73), while the role of the other three owners' types is relatively larger (for both "State & Foundations" and "Widely-Held" the difference is statistically significant).

These findings could be interpreted as the result of the historic pattern of ownership in Italy (Aganin and Volpin, 2003). Family-owned companies lacking financial resources (required, for example, for growth or to overcome distressed situations[30]), in order to keep the control, especially in terms of direct management of the firms (Table IV), adopt voting trust agreements sharing the control with other large

[29] As long as the privatization process, at both State and Local Governments levels, takes place, one could expect a growing involvement of State in voting trusts. Since recently, due to both political pressure and more strict regulation at UE level, Italian law has reduced the extent of golden share privileges (virtually a substantial control also on companies where the State shareholdings were insignificant) enjoyed by the Italian State, if it wants to keep control in key (partially) State-owned companies it should be much more prone to voting trusts' mechanisms. "*Con un emendamento alla Finanziaria il Governo introduce una versione morbida dei "poteri speciali" sulle società pubbliche [...] Rimangono immutate le società su cui si applicano. Sono quelle "controllate direttamente o indirettamente dallo Stato" che operano nei settori della "difesa, dei trasporti, delle telecomunicazioni, delle fonti di energie e degli altri pubblici servizi". Le possibilità di utilizzo dei poteri speciali rimangono quattro ma vengono modificate, in alcuni casi, in modo sostanziale. In particolare non è più prevista la possibilità di esprimere un gradimento, ma solo un' "opposizione" nel caso in cui un socio acquisisca una partecipazione rilevante o nel caso in cui vengano stretti patti o accordi societari da parte di almeno una ventesima parte del capitale sociale*". From *IlSole24Ore*, 12th December 2003.

[30] As Amatori and Brioschi (1997) observe: "*è interessante notare come questo fenomeno debba essere ascritto, in misura non marginale, ai risultati economici ben poco soddisfacenti che, almeno a partire dagli anni sessanta, hanno caratterizzato i grandi gruppi privati: la formazione di coalizioni di controllo è stata in non pochi casi dettata da esigenze di ricapitalizzazione che il singolo soggetto controllante non era più in grado di sostenere. In questo quadro, decisivo è stato il ruolo di Mediobanca che ha avuto (e*

shareholders. This sort of "external finance" channel represents a compromise, in the sense that accepting the presence of other large "friendly" shareholders is a bearable cost (in terms of sharing of private benefits) if compared with the issuance of new shares[31] which dilute the controlling stake making easier takeover bids.

Table IV: Trust's Largest Shareholder Appointing the Management

	Trust's Largets Shareholder				*Obs.*
	Families	State & Foundations	Foreign	Widely-held	
Management Rights:					
Yes	53	1	3	2	*59*
No	3	6	3	3	*15*
Total Sample	56	7	6	5	*74*

The relationship between ownership and control is not only affected by the relation between cash-flow rights and voting rights but also (and often, more importantly) by the relation between voting and control rights. Perhaps the most relevant control rights are the board rights. They are at the same time an instrument of securing the extraction of private benefits of control through the influence on the decisional process of the board, and a private benefit themselves (Shleifer and Vishny, 1997).

Table V shows the distribution of the rights attached to the shareholdings held in voting trusts. The separation between cash-flow rights and voting rights in firms included in the sample is modest. In particular, the average ratio between cash-flow rights and voting rights is equal to 97%. This can be attributed to the low incidence of non-voting shares within the equity structure of the companies in included in the sample.

In contrast, the separation between voting rights and board rights is dramatic. While on average the voting trust as a whole can exercise the 53,44% of the company's

continua ad avere nonostante i recenti insuccessi) un ruolo centrale negli assetti proprietari e di controllo dei grandi gruppi italiani".

[31] The same logic applies to IPOs: Zingales (1995) formalized a model predicting that where private benefits of control are larger, entrepreneurs should be more reluctant to go public, and more likely to

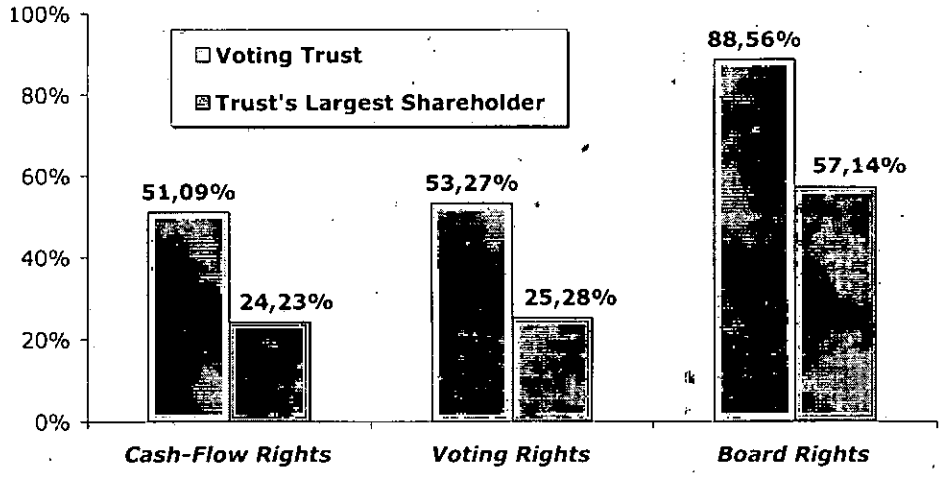
voting rights, it controls the 87,35% of the total board rights. The wedge is striking also for the largest shareholder within the trust. That shareholder is able to capture the majority of the board seats exercising just the 28,68% (just below the 30% level that triggers a mandatory bid offer of the total voting rights.

Table V: Allocation of Rights in Voting Trust

	Obs.	Mean	Median	Std. Dev.	Min	Max
Cash-Flow Rights:						
Voting Trust	*74*	51,97%	51,09%	16,29%	10,90%	88,01%
Trust's Largest Shareholder	*74*	27,77%	24,23%	16,40%	3,00%	83,62%
Voting Rights:						
Voting Trust	*74*	53,44%	53,27%	16,09%	14,84%	100,00%
Trust's Largest Shareholder	*74*	28,68%	25,28%	16,75%	3,00%	83,62%
Board Rights:						
Voting Trust	*74*	87,35%	88,56%	7,66%	70,00%	100,00%
Trust's Largest Shareholder	*61*	57,42%	57,14%	14,80%	18,18%	88,24%

In other terms, observing the median values obtained from the sample, as shown in Graph I, the median trust owns the 51% majority of the cash-flow rights controlling the voting rights attached to them, and is able to appoint almost the 90% of board directors. The median largest shareholder owning no more than a quarter of the total cash-flow rights is entitled to allocate the majority of the board's seats.

Graph I: Median Values of Rights in Voting Trusts



retain control when they do go public. The reluctance showed by Italian entrepreneurs toward the going public process is described by Massari (1992) and Pagano et al. (1998).

Finally, if one wants a simple "take-away" coefficient to express how much the participation in an Italian voting trust is beneficial, Table VI shows such a number. The voting trust as a whole leverages its voting rights gaining a +63% in terms of board rights exerted. One unit of voting rights almost doubles to the largest shareholder in the trust giving her 1,96 units of board rights. In contrast, to the median of the ratio between board rights and voting rights reaches a value of 1,39.

That lack of proportionality is extremely insightful, since it means that the largest shareholder, in comparison with the others within the trust, gets much more board rights than an allocation on equality base should have attained. Hence, the gathering of large shareholders in a voting trust determines the binding of the majority of voting rights, thus insulating the controlled company from the market for corporate control. Moreover, those minority shareholders within trusts, consent the largest shareholder to exercise both the majority of board rights and, usually, the direct management of the controlled company, but they require, at least, the right to appoint some board directors and/or "Collegio Sindacale" members in order to monitor the largest shareholders in charge of the company's direct control.

The above mechanism has been used for decades by many of the largest Italian listed companies, often on a reciprocity o circular base, in order to protect and stabilize the control of key family controlled companies and financial institution[32].

[32] Amatori and Brioschi (1997) point out that "*i gruppi italiani privati (o le imprese single) che, nel contesto internazionale, possono essere considerati di grande dimensione sono, ora come cinquanta anni fa, estremamente limitati nel numero. Con poche eccezioni essi sono inoltre legati da un consolidato sistema di alleanze di cui i legami azionari mutui sono il segno e lo strumento: a livello delle grandi decisioni strategiche il sistema dei gruppi privati italiani è quindi attualmente caratterizzato da un notevole grado di collusività così come lo era mezzo secolo fa. Anche in conseguenza di ciò gli assetti di controllo sono attualmente bloccati, così come lo sono stati [...] per tutto l'arco di tempo considerato. [...] In questi ultimi anni, per motivi di costo, i grandi gruppi da un lato hanno teso a ridurre il numero dei livelli delle piramidi societarie, dall'altro hanno fortemente ridimensionato l'emissione di azioni di risparmio, che la diminuzione dei tassi di interesse ha reso meno conveniente per le società emittenti. I legami azionari (monodirezionali e/o mutui) fra gruppi differenti sono invece progressivamente aumentati: in non pochi casi essi hanno rilevanza ai fini del controllo dal momento che concorrono a formare le coalizioni alla testa di numerosi gruppi e/o imprese*".

Table VI: Separation Between Voting-Rights and Board-Rights

	Voting Trust	Trust's Largest Shareholder	Other Shareholders (within the Trust)
Median Board-Rights/Voting-Rights Ratio	1,63	1,96	1,39

This assessment is coherent with the picture commentators purport to be the very distinctive feature of the "elite" circle within the Italian capitalism. As pointed out by Barca and Becht (2001): "in Italy, the popular complaint about the *salotto buono* is not the ways its members exert control, but the fact that they shield each other from control challenges".

These findings assume a further relevance if compared with the extent to which board rights are generally exerted by shareholders in other countries. Hence, within different national and regulation settings, the fact that large shareholders and even majority shareholders themselves are allowed to exercise some board rights should not be taken for granted. In particular, in many countries the ability of large shareholders to exercise board rights is severely limited by regulations protecting minority investors and/or management.

In UK, for example, the listing requirements of the London Stock Exchange (Section 3.13) require companies to ensure that their relationship with shareholders that own at least 30% of the total shares is at "arm's length".

In practice, this "arm's length" principle imposes very severe limitations on a block-holder's ability to monitor and influence management. In particular, the composition of the board must be such that all its significant decisions are taken independently of controlling shareholders and the company must implement rules that allow it to deal with the conflicts of interest of directors appointed by the controlling shareholder. The listing agreement specifies that the controlling shareholder cannot appoint more than 5 out 12 directors, the removal of directors not appointed by the controlling shareholder is subject to a 2/3-minority board decision, and capital increases must not dilute the voting power of non-controlling shareholders.

In the US there are similar rules that prevent large shareholders from exercising their voting power. For example, Black (1990) reports that shareholders acquiring 10-20% of voting rights are considered to exert control. To protect minority investors large shareholders are held liable like directors. In combination with other minority protection provisions US boards, like UK boards, can be immune to both monitoring and influence exerted by large shareholders[33]. In particular, the independence of US boards from shareholders influence determines their ability to ignore large shareholders proposals.

Paradoxically, from the point of view of the board rights' allocation, US managers resemble Italian large minority shareholders participating in a voting trust: they both have a substantial control of a company's boards despite owning only a minority fraction of its equity.

[33] However, unlike the UK, the US does not have a mandatory bid rule and tender offers must be negotiated with the board. As a result, devices that enable boards to protect small investors from large shareholders become devices that are used to protect boards (and management) from takeover bids.

3 The Information Content of Voting Trust Announcements: An Event-study Analysis

"The secret of success in business is knowing something no one else knows"

ARISTOTELE ONASSIS

3.1 Do Voting Trusts Announcements Have Information Content?

3.1.1 Legal Framework of Voting Trusts' Disclosure to the Market

The previous chapter reports the mandatory information that shall be included in extracts of voting trusts' agreements to be delivered to CONSOB. This chapter will focus further on the way information concerning voting trusts are disclosed and disseminated to the market, according to the Italian law. The disclosure requirements for shareholder agreements are included in the already mentioned Article 122 which states that agreements, in whatsoever form concluded, whose object is the exercise of voting rights in companies with listed shares or companies that control them shall be:

1. notified to Consob within five days from the date of their conclusion;
2. published in abridged form in the daily press within ten days from the date of their conclusion;
3. entered in the Company Register of the place where the company has its registered office within fifteen days from the date of their conclusion.

Moreover, those shareholders' agreements shall be null and void in the event of non-compliance with the above requirements. Voting rights attached to listed shares for which the above requirements have not been satisfied may not be exercised.

In order to evaluate the effectiveness of this regulation, it could prove useful to make a comparison with the both US and French shareholder agreements' disclosure regulation.

The section 403 of the Sarbanes Oxley Act states that the information about ownership and transactions involving management and principal stockholders should be communicated to SEC "before the end of the second business day following the day on which the subject transaction has been executed". Furthermore, the same content should be delivered to SEC also "electronically" and "the Commission shall provide each such statement on a publicly accessible Internet site not later than the end of the business day following that filing", and "the issuer (if the issuer maintains a corporate website) shall provide that statement on that corporate website, not later than the end of the business day following that filing".

This regulation results in a more effective system of disseminating relevant financial information to the market. The US legislator acknowledges the role of Internet in enhancing the transparency of corporate information: in the SEC words[34], "since 1996, we have required all domestic public companies to make their filings electronically through the EDGAR system, absent an exemption. EDGAR filings are disseminated electronically and displayed on our web site at http://www.sec.gov. The EDGAR system's broad and rapid dissemination benefits the public by allowing investors and others to obtain information rapidly in electronic format. Electronic format is easy to search and lends itself readily to financial analysis, using spreadsheets and other methods[35].

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[34] *Rulemaking for EDGAR System*, www.sec.gov.

[35] Furthermore, SEC explains that: "*recent technological advances, most notably the rapidly expanding use of the Internet, have led to unprecedented changes in the means available to corporations, government agencies, and the investing public to obtain and disseminate information. Today many companies, regardless of size, make information available to the public through Internet web sites. On those sites and through links from one web site to others, individuals may obtain a vast amount of information in a matter of seconds. Advanced data presentation methods using audio, video, and graphic and image material are now available through even the most inexpensive personal computers or laptops*".

On the contrary, the French legal framework, which regulates voting trusts (that strictly resemble the Italian analogues), is less severe than the American one. In particular, shareholder agreements containing any clauses identified by the New Law[36] must be submitted to the CMF within five trading days following the execution of the agreement. Furthermore, the amendment or termination of such an agreement must be similarly reported to the CMF.

The CMF must ensure that agreements (or the termination of such agreements) submitted to it be made public if they contain provisions falling within the scope of the New Law. In practice, the CMF issues a notice entitled "publicity of the clauses of an agreement contemplated by Article L. 233-11 of the Code of Commerce." As with all CMF notices, this is made available to the public on the CMF website (http//www.cmf-france.org)[37].

The law does not stipulate a maximum period of time that may pass between the parties' submission of a shareholder agreement to the CMF and its publication by the CMF. A review of recent notices issued by the CMF shows that the CMF issues the notice almost immediately after disclosure by the parties, usually on the same or the next trading day[38].

Finally, the CMF does not make public the full contents of the shareholder agreement[39] but, like for Italian extracts, does publish the names of the parties, the duration of the agreement and a short summary of the agreement's principal provisions. The notice includes a summary of all of the provisions of the agreement, not only those provisions affected by the statute.

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[36] Law n° 2003-706 of August 1, 2003 on financial security (*Loi de Sécurité Financière*) (the "Reform") was adopted by the French Parliament one year after the U.S."Sarbanes-Oxley" Act with the same objective of restoring the trust of the investors in the French markets.

[37] M. Goldberg-Darmon, "Transmission des pactes d'actionnaires au Conseil des marchés financiers", in *Option Finance*, 2003. See also J. Philibert, "Pourqoi les pactes d'actionnaires ont du success", *Le Figaro*, 30 August 2004, and F. Giaoui, "Pactes d'actionnaires et investisseurs", *La Tribune*, 6 April 2004.

[38] M. Goldberg-Darmon, *ibidem*.

[39] The AMF (Autorité des Marchés Financiers) , that is the French Securities and Exchange Commission, does not require the full disclosure of voting trusts' agreements: "*en pratique, cette publicitè consiste en un résumé des principales caractéristiques de la clause [...] et non pas une publication intégrale, pour des raisons de confidentialitè*" (M. Goldberg-Darmon, *ibidem*) .

Coming back to the Italian legal framework, the ad hoc regulation about voting trusts' disclosure differs substantially from the regulation of the Article 114 of the Consolidated Law on Finance regulating the "*information to be provided to the public*". That article states that: "*without prejudice to the information requirements established by specific provisions of law, listed issuers and the persons that control them shall inform the public of events occurring in their or their subsidiaries' sphere of activity that have not been made public and that if made public would be likely to have a significant effect on the price of the listed financial instruments*". Hence, this article resembles the "price sensitive" disclosure to the market provision adopted by the major stock exchanges and securities commissions around the world[40].

The *Consolidated Law on Finance* requires a disclosure procedure tailored *ad hoc* for voting trusts' information. In particular, there is a significant difference from the point of view of the timing. While the regulator clearly acknowledges the relevance of voting trusts' information disclosure, she implicitly does consider such information to have not such the "urgency" which is usually assumed when dealing with "price sensitive" information. In the comment of the 114 Article, Marchetti and Bianchi (1999) underline that:

> "*[...] Nè può ritenersi che gli obblighi di pubblicità cui la disposizione si riferisce abbiano ad oggetto le altre comunicazioni (alla Consob o al pubblico) previste dallo stesso T.U. Ciò emerge chiaramente dal fatto che ove il legislatore ha voluto riferirsi a tali ultimi obblighi informativi li ha espressamente previsti e menzionati con differente terminologia ([...]art. 122).*"

[40] This article has a strict link with the Article 180 about the insider trading (Linciano and Macchiati, 2002). In particular, the law establish that any person who, possessing inside information by virtue of holding an interest in a company's capital or exercising public or other duties, a profession or an office:

a) makes purchases or sales or carries out other transactions, directly or through a nominee, involving financial instruments on the basis of such information;

b) divulges such information to others without good cause or advises others, on the basis thereof, to carry out any of the transactions referred to in subparagraph a).

Moreover, the law any person who, having obtained, directly or indirectly, inside information from persons referred to the above paragraph, commits any of the acts described in subparagraph a) thereof.

Since the main hypothesis we are going to test in this work is whether voting trusts' announcements have information content, implicitly we will evaluate if this distinct way of communicating voting trusts' information could be considered adequate and fair.

3.1.2 Disentangling the "Entrenchment Effects" of Italian Voting Trusts

The effects of ownership structures on the value of firms have been a central item in the finance scholars' agenda since the Seventies, when Jensen and Meckling (1976) identified large shareholders who have both strong incentives and power to discipline the management, as a medium to increase firm value. While the positive incentive effects of large ownership (mainly of managers) have been researched extensively, much less work has been done on the costs – in terms of lower firm valuation – associated with the presence of large investors. Fama and Jensen (1983), DeAngelo and DeAngelo (1985), and Barclay and Holderness (1989) argue that increased insider ownership concentration permits managerial consumption of perquisites and "entrenchment" of incumbent management by reducing the probability of bidding by outside agents, thus reducing firm value.

Stulz (1988) develops a theoretical model, formalising the costs of large shareholders and entrenchment, which predicts a concave relationship between managerial ownership and firm value. In this model, as managerial ownership and control increase, the negative effect on firm value associated with the entrenchment of manager-owners starts to exceed the incentive benefits of managerial ownership. As a consequence, the entrenchment costs of managerial ownership, in terms of a lower firm value, relate to managers' ability to block value-enhancing takeover or to make them more costly to the bidder.

Empirically, the already cited contribution by Mork et al. (1986) finds an inverse U-shaped relationship between managerial equity ownership and firm valuation (measured as *Tobin's Q*, that is the ratio of firm market value to replacement value of its assets) for a sample of US firms. They find that the ownership concentration has a positive effect on Q until insider ownership reaches 5 percent, a negative effect between 5 and 25 percent, and a weak positive effect after the 25 percent.

In the "most macabre" study ever performed in the finance literature, Slovin and Sushka (1993) analyse the market reaction to announcements of deaths of insiders who own at least 5 percent of firm shares. They find significant, positive abnormal returns to the announcements of insider block-holders' deaths. Moreover, they show that for a large portion of firms in the sample, disposition of the deceased's shareholdings leads to a reduction in the control group block and to subsequent corporate control bids. This article, which is the closest to our work from the methodological point of view, is broadly consistent with the Stulz's (1988) model, supporting the thesis that the firm value is positively related with its openness to the market for corporate control while, on the contrary, is negatively affected by ownership structures in which a substantial portion of shares is held by insiders.

Since ownership structures exhibit relatively little concentration in US, no other relevant empirical attempt to study the relation between ownership concentration and firm value has been performed to date. Recently, an interesting contribution is the study of 1.301 listed companies in eight East Asian countries performed by Claessens, et al. (2002). They show that firm valuation increases with cash-flow ownership in the hands of the largest shareholder, coherently with an incentive effect. But, a substantial entrenchment effect, in terms of lower firm values, clearly emerges as long as the control rights of the largest shareholder increase. Moreover, this negative effect is particularly severe for large deviations between control and cash-flow rights.

The present work represents an effort to investigate the existence of entrenchment effects in Italian companies controlled through voting trusts. In particular, we follow, on the one hand, the reasoning line proposed by Stulz (1998) about the relation between insider ownership and market for corporate control, and, on the other hand, the insights from the literature about the separation between ownership and control. We attempt to merge those reasoning lines in order to assess how voting trusts' functioning, and the implied openness to market for corporate control they determine, actually affects firm value.

3.2 Voting Trusts and the Market for Corporate Control: a Stylized Model

The simple model illustrated below shows the basic intuition this thesis is based on. Bebchuk et al., (2000) propose a formalization of the corporate control transactions in order to evaluate the agency costs generated when there is a separation between cash-flow and voting rights.

The model considers an initial controller I owning a fraction α of company's cash-flow rights. Under the control exerted by I, the value of the company is V_I which consists of sum of cash-flow C_I and private benefits of control B_I. Under a potential new controller, N, the corresponding values would be, respectively, V_N, C_N, and B_N. Bebchuk et al. (2000) demonstrates that a transfer of control from I to N will be efficient if and only if

$$V_I = C_I + B_I < V_N = C_N + B_N.$$

In particular, under the "equal opportunity rule", which implies that non-controlling shareholders are entitled to participate in a transfer of control on the same terms as the controller, the initial controller I will sell his control stake if and only if

$$\alpha V_N > \alpha C_I + B_I,$$

meaning that the transfer of control takes place only if the sum of his cash-flow right portion and the private benefits he is able to extract is less than the portion of the value – that basically means price – the potential new controller will attribute to the control of the firm.

The key point of this model relies on the fact that, since α can be as small as desired – mainly thanks to the separation between ownership and control due to pyramids, dual-class stocks and cross-ownership (*supra* § 1.1.2) – the decision of controller I to sell the firm will depend much less on V_I and V_N, the values of the firm in the hands of I and N, than on the relative sizes of B_I and B_N, the private benefits of I and N.

Extending this model to the voting trust mechanism, we are able to illustrate how the separation between cash-flow and control rights obtained through a voting trust, affects the market for corporate control of companies held by such a device.

Suppose that a firm is controlled by the voting trust T, then its value is

$$V_T = C_T + B_T$$

consisting of the sum of cash-flow C_T generable by the firm under the trust's control and private benefits of control, extracted by the trust, B_T.

Suppose, then, that the trust is composed of n members owning, as a whole, the fraction α of the total cash-flow rights of the firm (C_T). Then each i-member of the trust owns the fraction α_i of the cash-flow such as

$$\sum_{i=1}^{n} \alpha_i = \alpha .$$

Suppose also that the trust is able to extract the private benefits of control B_T which are shared only among trust's members[41] and not with shareholders outside the trust – this descends from the definition itself of private benefits of control – allocating to each member the fraction β_i (such as $\sum_{i=1}^{n} \beta_i = 1$) of B_T.

Finally, suppose that only two states of the world exist: one in which the trust works and one in which the trust is not able to work effectively (e.g. the members cannot reach an agreement on major decisions). Thus, a (reasonable) implication is that the extraction of the private benefits of control is possible if and only if the trust does

[41] We find theoretical support about the divisibility of private benefits of control in Zwiebel (1995). He states that "*while private benefits of control have received much attention recently, much of this literature is vague on the origins of these benefits. Among plausible sources are the ability of management (or directors) to dilute corporate funds for private benefits, synergies obtainable through mergers, favors conferred by a firm, access to inside information, perquisites of control, and utility derived directly from power or control. While most previous paper have modeled these control benefits as indivisible, all these sources are likely to yield benefits shared by a number of individuals. If benefits are indeed divisible, it is*

work. We capture this idea stating that private benefits of control B_T are a function of trust effectiveness E which assumes alternatively the value 1 when the trust works well, and 0 otherwise.

In this setting, the value of the stake for the *i*-member of the trust is V_{Ti} defined as

$$V_{Ti} = \alpha_i C_T + \beta_i B_T(E), \text{ such as } \sum_{i=1}^{n} V_{Ti} = V_T .$$

In this setting, the *i*-member of the trust will sell her stake to the potential new controller N if and only if

$$\alpha_i V_N > V_{Ti}$$

or rearranging the terms,

$$V_N > [\alpha_i C_T + \beta_i B_T(E)] / \alpha_i.$$

It is worth noting that while the presence of the fraction α_i still implies (as in general case) that the lower the stake held by the the *i*-member of the trust, the more the decision to sell depends upon the relative sizes of private benefits of control of B_I and B_N, rather than upon the values of the firm V_T and V_N. Moreover, in this model, the decision to sell is dramatically determined by the allocation of private benefits of control (β_i) and, especially, by the effectiveness of the trust itself.

When the trust works well, the extraction of private benefits is allowed, and E is equal to 1. Thus, the last expression becomes

$$V_N > [\alpha_i C_T + \beta_i B_T] / \alpha_i.$$

Conversely, if E is equal to 0 meaning that the trust's members are unable to extract the private benefits of control which are generable within the firm, then previous expression becomes

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natural to presume that the degree of control an investor derives from a block will depend on the

$\alpha_i V_N > V_{Ti} = \alpha_i C_T$.

This result implies the intuitive idea that if the *i*-member of the trust could not enjoy his portion of private benefits of control (e.g. he is rejected from the trust), then he should value his stake no more than the attached fractional claim on the company's cash flow. If this condition is respected for each member of the controlling trust, also the dispersed minority shareholders (who value their shares only on the basis of their expected cash-flow portion) should sell their shares if and only if

$(1-\alpha) V_N > (1-\alpha) C_T$.

It follows that if a potential buyer who valuates the company (or the single stake) something more than the total cash-flow generated by the firm under the control of the voting trust, then he will succeed in buying the company. (In particular, the new controller is willing to pay something more then the cash-flow rights currently generated by the firm, because he expects to improve the cash-flows due to a superior management of the firm after the takeover, and/or he conjectures to be able to extract more private benefits of control from the company than the voting trusts currently does).

A numerical example could prove useful[42]. Suppose that a firm is controlled by the trust T, which holds 50% of the cash-flow rights (this is almost the value we empirically found in the previous chapter). The trust is composed by 4 members (the median value we found in our analysis) each of them owning a 12,5% stake of the company. Under the control of the trust the cash-flow value of the company is supposed to be 1000, and the exploited private benefits are, modestly, equal to 100 (let us consider this value as the monetary equivalent of pure "non-pecuniary" private

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strategic importance of this block in forming controlling coalitions".

[42] We therefore assume an "equity opportunity rule" from the point of view of the takeover mechanism. The Italian public offer regime does not precisely fit this system since the 1998 *Consolidated Law on Finance* requires all the public offer (to buy all the shares listed on Italian regulated markets) to be launched at a price no lower than the arithmetic mean of the weighted average market price in the last twelve months and the highest price agreed in the same period by the bidder for the purchase of shares of the same class. Anyway, the results of the model hold also if the Italian takeover-system regime is assumed.

benefits). Then the total value of the company is equal to 1100 that is the sum of total cash-flow claims and private benefits generated:

$V_T = C_T + B_T = 1000 + 100 = 1100.$

(Note that, in this example, the incidence of private benefits is well below the 29% and 37% sizes identified respectively by Nenova (2003) and Dyck and Zingales (2003) for Italian companies).

The private benefits of control are assumed to be shared on equal base among the 4 shareholders. That means that each trust's member extracts 25 (=100/4) as a benefit resulting from the shared control of the firm.

Then, how much a potential bidder should offer in order to succeed in taking-over the company? Since the value of the company currently is 1100, he could rationally propose a bid such as $V_N > 1100$. Let us try, as a first guess, 1140.

If the controlling group accepts the offer, this would be an efficient transaction, since the minority shareholders receive a 14%[43] premium for their 50% (that is 1-α) fraction of shares. However, this efficient transaction will not take place because no one of the controlling trust's members will sell his stake. Since, following the above formalization, the value of the stakes, for each of them, is equal to sum of cash-flow rights and private benefits attached to the stake ($\alpha_i C_T + \beta_i B_T$), thus they value their stakes as much as

12,5% (1000) + (1/4)(100) = 150.

Hence, the condition enabling the selling ($\alpha_i V_N > V_{Ti}$) is not satisfied because under a valuation of the firm equal to 1140, each trust's member would be offered 142,5 (=12,5%*1140) which is below 150 the value they assign to their stakes (including the attached fraction of private benefits of control).

In this example, the selling condition ($\alpha_i V_N > V_{Ti}$) is respected only with bid values based on the relation $12,5\% V_N > 150$, leading to a firm valuation equal to $V_N >$

[43] That it straightforward: they sell their 50% stock, which currently is valued 500 (=1000*50%) on the basis of the expected cash-flow at a value equal to 570 (= 1140*50%). Their premium is 70 (=570-500) which represents a +14% (=70/500) over the current value of the firm.

1200. In other terms, the premium to be offered in order to gain the control of this firm should be above 20%[44].

What happens if the voting trust's members are no more willing or able to work together sharing the private benefits of control extractable from the controlled firm? In this case, the value to each of the trust's members is based only on the value of their portions of firm's cash-flow ($\alpha_i C_T$) that are singularly equal to 125 (=12,5%*1000). Thus, now the selling condition ($\alpha_i V_N > V_{Ti}$) determines bid values according to the relation $12,5\% V_N > 125$, that (obviously) leads to a valuation equal to $V_N > 1000$. In this case each positive premium (>0) succeeds in taking-over the firm.

If there are no private benefits of control within the firm, or the controlling group is unable to extract them, then the valuation of the firm is based only on projected cash-flows, and a potential bidder should be able to take-over the company just paying something more than the current firm's cash-flow. Conversely, if private benefits do exist, a certain range of efficient transactions (in this example, all the transactions based on premiums >0 and ≤ 20%) could not successfully take place.

The tricky mechanism of the model relies on the fact that a further separation between cash-flow rights and control, determines a larger premium required by the controlling group in order to give-up the control. (In the model, this is due to the fact that, since α is placed in the denominator of the ratio, as it declines, the range of efficient transactions increase exponentially).

[44] Within the Italian legal framework of takeover, actually the cost for the bidder is lower than 1200. Supposing that the cash-flow value (C_T) assumed equal to 1000 did not changed during the last year, represented by 1000 shares (500 owned by the voting trust's members and the other 500 owned by dispersed shareholders), is efficiently reflected in market prices. The Italian public offer rules requires a price for the offer "no lower than the arithmetic mean of the weighted average market price in the last twelve months and the highest price agreed in the same period by the bidder for the purchase of shares of the same class". If the bidder privately negotiates the acquisitions of blocks held by the trust's members, he should set a price above 1,2 per share (1200/1000) for the 500 shares held by trust. The price offer for the other 500 shares on the market should be above (1,2+1)/2 that is 1,1. Thus, the overall cost for the takeover is above 1150 (=1,1*500+1,2*500). Also in this case 1140 is not enough to take the control of the firm, even if it still is an efficient transaction from the market point of view. The Italian takeover rule, in respect with the "equal opportunity rule", makes public offers less costly (1150 vs. 1200), but still the presence of private benefits of control impede some offers which would benefit minority shareholders.

In order to illustrate this point, suppose that, in the situation described in the above example, one of the trust's member holds now a 10% stake in the company while the other three still hold their 12,5% stakes. Then, the trust as a whole controls a 47,5% stake (which still consents an easy defence of the control, in case a hostile takeover is launched). If the private benefits of control continue to be shared among the 4 members on a equal base, then the value of the shares (again derived from the sum $\alpha_i C_1 + \beta_i B_1$) held by the 10% trust's member becomes

$$10\%(1000) + (1/4)(100) = 125.$$

As a consequence, the selling condition ($\alpha_i V_N > V_{Ti}$) is respected only with bid values based on the relation $10\% V_N > 125$, that leads to a valuation equal to $V_N > 1250$. In other terms, the minimum premium to be offered in order to gain the control of this firm should be above 25%!

Finally, it is worth to note that the same mechanism here formalised applies also to the selling decision of single stakes held in the trust. If a large shareholder is ejected from the trust, and the trust could replace him or is able to work effectively even without him, then the value of this shareholding outside the trust (and thus without substantial private benefits of control attached to the stake) should be sold at a price no significantly above the market price of dispersed shares. In this case, the "block premium" (*supra* § 1.3.1) incorporated in a transaction is expected to be limited or null (or even negative in case of relevant illiquidity costs)[45].

[45] A recent example is the new voting trust which controls BNL. On April 30, 2004, *IlSole24Ore* reported that "*Bnl ha un nuovo patto di sindacato. Il principale azionista, lo spagnolo Banco di Bilbao Vizcaya (14,9%), le assicurazioni Generali (8,5%) e la Dorint di Diego Della Valle (4,99%) hanno definito nella tarda serata di mercoledì un accordo per conferire in un patto parasociale il 28,39% del capitale e mettere così al riparo la banca da un'eventuale Opa. [...] Un'operazione che però sembra più un arrocco che la risposta a una minaccia reale e ha il sapore di una risposta al malumore che gli altri due azionisti della banca, Mps (4,4%) e Banca popolare di Vicenza (3,4%), da qualche tempo avevano espresso sull'attuale governance di Bnl, lasciando capire nei giorni scorsi che sono pronti a uscire dal capitale*". In the subsequent days, Mps and Banca popolare di Vicenza tried to join the new controlling voting trust: as explained by *IlSole24Ore* (6 March, 2004) "*i soci di Bnl esclusi dal patto siglato tra Bbva, Generali e Della Valle, avviano i primi giri di consultazione per valutare la prospettiva di un accordo alternativo*". But, the efforts proved unsuccessful and just few days later the *IlSole24Ore* (15 March, 2004) reported that "*Viene allo scoperto lo scontro nell'azionariato della Bnl. La scintilla è stata la decisione, inevitabile dopo la sigla di un nuovo patto di sindacato a tre tra Bbva, Generali e Dorint (Della Valle), con cui ieri il cda ha rinnovato il comitato esecutivo in scadenza tagliando fuori Pierluigi Fabrizi, presidente della Banca Montepaschi, uno dei soci esclusi dal nuovo accordo di governance*".

Coming back to the main objective of this chapter, from the illustration of this simple model, we are able to draw the hypotheses to be tested in the empirical analysis. Since both the establishing of new trusts aimed to control a listed company as well as the renewal of existing trusts, represent a way of insulating (at least, to a certain extent) the firm from the market for corporate control, thus avoiding a range of efficient transactions (from the market point of view), then at the announcement of such events a negative response from the market is expected.

Conversely, when the termination of a voting trust is announced, and, as a consequence, the company's openness to potential bids increases, a stock upside should follow.

3.3 The Relevance of Voting Trusts' Disclosure: the Olimpia Case

On Saturday, July 28 2001, Pirelli (the Italian Italian tyre and cable firm) and Edizione Holding (the investment arm of the Benetton clothing-producer family) announced that they agreed to pay around 7 billion Euro for the 23% stake in Olivetti (whose main asset was the held by Bell, a Luxembourg-based holding company. The corporate vehicle created for this purpose was to be owned 60% by Pirelli and 40% by Edizione. In total it would own 27% of Olivetti when the companies' existing stakes in the company were factored in.

This coup was facilitated by Olivetti's poorly performing shares, which had lost around 20% of their value since the company had acquired its stake in Telecom Italia in 1999. The backers who had supported the CEO, Roberto Colaninno in that take-over through their involvement with Bell ran out of patience after two years of falling share prices for both Telecom Italia and Olivetti. The offer from Pirelli of $3.65 per Olivetti share was double the market price and proved more tempting than Colaninno's promises of future gains.

Finally, Mps and Banca popolare di Vicenza decide to quit (at least for the moment) the game: "*Banca Monte dei Paschi e Popolare di Vicenza escono dal capitale di Bnl, utilizzando lo strumento del prestito obbligazionario convertibile. Siena però non taglia definitivamente i ponti col gruppo romano, perché mantiene i diritti di governance per tutta la durata dell'operazione e, alla scadenza del bond, nel 2009, si riserva la facoltà di consegnare i titoli Bnl oppure pagare cash*". From *IlSole24Ore*, 11 June, 2004.

Pirelli, on the other hand, was well placed to make its move on Olivetti since it was sitting on around Euros 2.5 billion in cash after selling parts of its fibre optics business to Cisco and Corning. By focusing on the 23% of Olivetti controlled by Bell, Pirelli was able to avoid any offer to other Olivetti shareholders. This approach to the take-over (which simply followed in Colaninno's footsteps), was made possible through Italy's Consolidated Law on Finance which specifies that a bidder acquiring less than 30% of a company's equity need not make a full offer for that company.

Likewise Telecom Italia's other shareholders were not consulted or compensated when the offer was agreed. As the *Financial Times* caustically saw it, "Roberto Colaninno's reign at Telecom Italia has ended as it began: with abuse of minority shareholders"[46].

In seizing control of Telecom Italia with a market capitalisation of approximately $65 billion Pirelli had spent only around $7 billion. The FT calculated that Tronchetti controlled Telecom Italia with less than 0.5% of its equity and around 0.1% of its enterprise value[47]. *Business Week* remarked: "The behind-the-scenes story of Tronchetti's coup reveals how deals in Europe's third-largest economy still depend more on old-world alliances than on the rough-and-tumble justice of open markets. Pirelli, together with ally Benetton and two banks, took control of an empire with a market value of $99 billion for only $6.4 billion, thanks to the complex chain of holding companies created by Colaninno. The 80% premium goes to the handful of investors who own 23% of Olivetti. And Telecom Italia's outside shareholders? They get nothing"[48].

As the *New York Times* put it, the new twist in Telecom Italian's ownership, "was just one more peculiar Italian exercise in capitalism without capital"[49]. *Business Week*, for its part, saw it as "a throwback to the opaque governance that dominated corporate Italy for decades..."[50]. British and American investment funds protested

[46] *Financial Times*, 30 July, 2001.
[47] *Financial Times*, 2 August, 2001.
[48] *Business Week*, 13 August, 2001.
[49] *New York Times*, 3 August, 2001
[50] *Business Week*, 13 August, 2001.

loudly after the deal although "to deaf ears within a new Italian government whose priority (like its predecessors) seemed to be in keeping Telecom Italia in Italian hands whatever that might mean for shareholders' rights"[51].

Soon after the Colanino's resignation, on July 31, it was announced that Tronchetti was to become Chairman of Telecom Italia with Gilberto Benetton (of the Benetton Group) becoming Vice Chairman. It was also announced that Enrico Bondi (formerly CEO at Montedison) and Carlo Buora of Pirelli would become co-CEOs. Later it was reported that Bondi would also take over as Chairman at TIM. Looking at the new control structure few commentators regarded the change as an improvement from the perspective of Telecom Italia shareholders. As the *Financial Times* saw it, "far from being a victory for shareholder capitalism, this looks like one group of barons being replaced by another"[52].

Anyway, the market reaction at the deal announcement was strikingly negative: by the close of trading on Monday, July 30, Pirelli shares were down by over 16% (Graph II), the stock's biggest-ever one-day drop, wiping more than 1bn euros off the company's value. Analysts were almost unanimous in their condemnation of the deal, citing "an over-high price, the lack of synergies between the firms, and the failure to communicate strategy adequately to shareholders"[53]. Thus the market was waiting for a more clear picture about the both the financing and governance mechanisms consenting the transaction to the two joint bidders.

Such clarification was contained in the shareholders' agreement among Pirelli and Edizione addressing the shape of both the financial and governance relationships between the two parties. Both the content and the chronology regarding this agreement, particularly succeed in underlining how much relevant shareholders' agreements actually are from the point of view of the market. Then the chronology of events related the agreement is summarised below.

On August 3, the Pirelli and Edizione established the Newco (lately called "Olimpia") which was the vehicle to be used for the acquisition of the Olivetti stake

[51] *Financial Times*, 3 August, 2001.
[52] *Financial Times*, 30 July, 2001.

from Bell. On August 7-8, the two shareholders signed an agreement about the ownership and management of both the Newco and the companies controlled through it. The agreement was communicated on the following day (August 9) to CONSOB both in the integral version and in extract version as required by the Article 122 of the *Consolidated Law on Finance*. Also the requirement of paid advertisements on newspapers, reporting the key information about the agreement, was met on August 9.

Furthermore, on the same date, since Telecom Italia's shares are listed also on NYSE, the integral shareholder agreement was delivered to SEC. In fact, SEC requires full disclosure about relevant agreement regarding transactions among shareholders controlling companies listed on US markets (*supra* § 3.1.1).

Finally, on August 13, copies of the original agreement have been deposited with both the Milan and Torino/Ivrea Chambers of Commerce. Thus, all the actions required by the Italian law in relation the disclosure of the shareholders' agreement were exactly fulfilled.

Looking at the content of the published extract, the original text included the following statements:

> *"Qualora, nel periodo di durata dell'Accordo, a seguito di uno o più atti tra vivi a qualunque titolo, per quanto riguarda Edizione, i signori Luciano, Gilberto, Carlo e Giuliana Benetton, o loro coniugi o discendenti diretti, cessino di designare la maggioranza del consiglio di amministrazione di Edizione e, per quanto riguarda Pirelli, il dott. Marco Tronchetti Provera cessi, non per sua volontà determinante, dalla guida strategico-operativa del gruppo Pirelli, per tale intendendosi la Pirelli & C. Accomandita per Azioni e società da essa controllate direttamente e indirettamente, si ha "Evento Rilevante". Verificatosi l'Evento Rilevante rispetto a una Parte, l'altra Parte avrà diritto di cedere tutte le sue azioni di Newco alla parte rispetto alla quale si è verificato l'Evento Rilevante".*

On the first moment, this clause appeared innocuous to the market investors. But on August 15 (holiday in Italy) the *Corriere della Sera* reported the following information:

> *"Una clausola di garanzia che somiglia a una «pillola avvelenata» verso possibili scalatori. È quella che spunta nella versione consegnata alla Sec, la Consob americana, degli accordi tra Pirelli e Edizione Holding per la società che controllerà il 27% di Olivetti. I due gruppi avevano già reso noto che nel caso Marco Tronchetti Provera dovesse lasciare, non per sua volontà, la guida di Pirelli, la società veneta avrà il diritto di*

[53] *Reuters*, 30 July, 2001

chiedere la cessione dei suoi titoli della «newco» al gruppo milanese. Lo stesso avverrebbe se Benetton cessasse di avere la maggioranza in Edizione. Nel documento depositato oltreoceano si aggiunge però un particolare. Se Tronchetti o i Benetton venissero spodestati, facendo scattare il diritto alla richiesta, nella transazione il prezzo dei titoli della scatola che contiene il pacchetto di Olivetti dovrà essere moltiplicato per tre. Una parte potrà cioè vendere all'altra la sua quota a un valore pari al 300% di quello che dovrà essere stabilito da due banche nominate congiuntamente, da una terza, se le due non fossero d'accordo, o, in ultima istanza, dal Tribunale di Milano. La società della famiglia veneta però non è quotata, e quindi non è scalabile. Il suo azionariato e il suo consiglio di amministrazione potrebbero cambiare se i Benetton litigassero o vendessero. Ipotesi remota. Diverso è invece per Pirelli & C., dove Tronchetti ha il 25% e la maggioranza è garantita da un patto di sindacato che in caso di opa decade: un punto debole nella catena di controllo che porta a Telecom. Ma secondo la regola stabilita nell'accordo, un eventuale scalatore ostile di Pirellina dovrebbe sobbarcarsi oltre al costo dell'Opa, anche l'ulteriore rilevante onere della liquidazione di Edizione, acquistando a prezzi triplicati la parte Benetton della «nuova società». A quanto si arriverebbe applicando il 300% del prezzo?[...]Strappare il boccone Telecom a Tronchetti potrebbe allora diventare più indigesto, anche di 15 mila miliardi"[54].

The "300% clause" had not appeared in paid advertisements notifying the public of the agreement appearing in the Italian press because the paid advertisement was only an excerpt of the long filing document. The full document was not published on CONSOB's Web site. The document was deposited with the Italian Chamber of Commerce, where they are in the public domain, but an access fee is required.

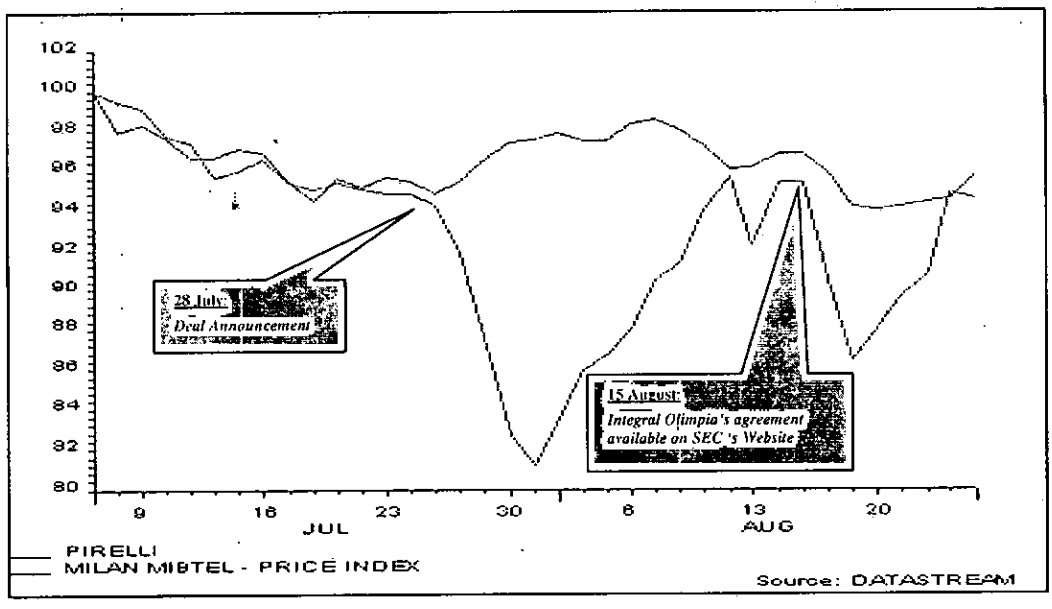
Thus, no wonder that "*a Pirelli spokesman pointed out Friday that the company has followed all necessary procedures of communication and advertising according to current legislation*"[55] and that "*It was unclear why the details about the takeover agreement were available first from the SEC, rather than Italian market regulators. Italian market watchdog Consob did not immediately return phone calls seeking comment*"[56].

The market reaction after the acknowledgment of the full content of the agreement was heavily negative on August 16 and 17. Cumulatively during those two days Pirrelli & C. (controlled by a voting trust where Tronchetti Provera had a modest 25% stake owned through Cam-Fin), which was the weakest link in the long chain controlling Telecom, performed a dramatic -9,85% as shown in Graph II. The market punished Pirelli & C. stocks price as long as "*some investors decided that the new pact*

[54] *Corriere della Sera*, 15 August, 2001.
[55] *Dow Jones Newswires*, 17 August, 2001.
[56] *Reuters News*, 17 August, 2001

governing control of Olivetti has lessened Pirelli's appeal as a potential target for a predator looking to gain control of Telecom"[57].

Graph 11: Pirelli &C. Stock Prices vs. MIBTEL, July-August 2001



This brief case study points out, at least, three issues. The first is the frequent adoption, within the Italian capitalism, of shareholder agreements' in taking over large listed companies. The second is the relevance of agreements' contents about the relationship between large shareholders tied in a voting trust. The last point is related to the high sensitiveness of both the ways and the timing information about voting trusts is disclosed and disseminated to the market. Thus, the Olimpia case corroborates our hypothesis about the information content of voting trusts' announcements.

3.4 Data and Methodology

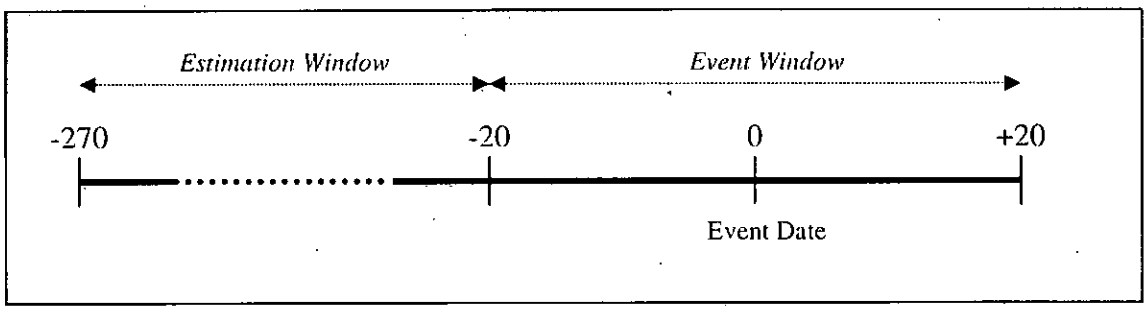
We obtain the announcements regarding voting trusts related to Italian listed companies from the database of *Radiocor/IlSole24Ore*, which is a leading Italian financial news agency. We examine the period 1995 through 2003, searching for news about the establishment of new trusts, and the renewal or termination of existing ones.

[57] *Dow Jones Newswires*, 17 August, 2001.

We do not take into consideration announcements where other relevant financial information (e.g. earnings announcement, CEO's turnover) is conveyed to the market together with the information about the trust. We finally find 56 events we group into two samples. One sample includes 40 announcements related to new voting trusts or to renewals of existing ones. The other sample contains 16 announcements which refer to the termination of voting trusts.

Following the original MacKinlay's (1997) study, we employ a 41-tranding-days event window, comprised of 20 pre-event day (from -20 to -1), the event day (day 0) and 20 post-event window (from 1 to +20). The estimation, for each announcement, is comprised, as shown in Figure I, of 250 trading days (from -270 to -21).

Figure I: Time-line for the Event Study



The appraisal of the event's impact requires a measure of the abnormal return. The abnormal return is the actual *ex-post* return of the security over the event window minus the normal return of the firm over the event window. The normal return is defined as the expected return without conditioning on the event taking place. For firm i and event date t the abnormal return is

$$AR_{it} = R_{it} - E(R_{it})$$

where AR_{it} , R_{it} , and $E(R_{it})$ are the abnormal, actual and normal returns respectively for time period t. in order to model the "normal" return, we use a market model which assumes a stable linear relation between the market portfolio return - in this case the MIBTEL index - and the security return. Thus, for any security i the market model is

$$R_{it} = \alpha_i + \beta_i R_{MIBTELt} + \varepsilon_{it} \text{ , with } E(\varepsilon_{it}) = 0 \text{ and } Var(\varepsilon_{it}) = \sigma^2_{\varepsilon_i}$$

where R_{it} and $R_{MIBTELt}$ are the period-t returns on security I and the market portfolio, respectively, and ε_{it} is the zero mean disturbance term. α_i, β_i, and $\sigma^2_{\varepsilon_i}$ are the parameters of the market model.

The abnormal return observations must be aggregated in order to draw overall inferences for the event of interest. The aggregation is along two dimensions: through time and across securities (MacKinlay, 1997).

First we consider the cross-sectional aggregation crossing events by using the abnormal returns. Given the number, N, of events, we have the sample aggregated abnormal returns at time t for our event period from day –20 to +20 around event defined as

$$\overline{AR}_t = \frac{1}{N}\sum_{i=1}^{N} AR_{it}$$

where $\overline{AR}_t$ denote the average of the abnormal return crossing events.

Then, we aggregate the average abnormal returns over the event period in order to get the average Cumulative Abnormal Return $\overline{CAR}$. Then from $\tau 1$ to $\tau 2$ over an event period of 41 days the average cumulative abnormal return is expressed as:

$$\overline{CAR}(\tau 1, \tau 2) = \sum_{\tau=\tau 1}^{\tau 2} \overline{AR}_{i\tau}.$$

Finally, in testing for statistical significance, the null hypothesis is that average abnormal returns are equal to zero for each event sub-period and for each portfolio[58]. Furthermore, we apply a non-parametric test, the Wilcoxon Signed-Ranks test, following the suggestion by Cowan and Sergeant (1997).

[58] If we assume that the average abnormal returns over all companies are independent, identically distributed and come from a normal distribution, the test statistic is distributed as a Student's *t*.

3.5 Results and Discussion

3.5.1 Voting Shares

In Table VII we report the event study results about the valuation effects at voting trusts' announcements. The announcements are classified according the dichotomy "New/Renewal" and "Termination". In particular the Table VII shows an average abnormal return (AAR) on the announcement day (day 0) equal to -2,47% for the "New/Renewal" category and +2,8% for the "Termination" announcements. There is also a robust evidence of the announcement effect on day 1. The average abnormal returns are -3,35% and +4,94 for the "New/Renewal" and "Termination" announcements respectively. The source of these day-one effects is likely to be that some voting trust announcements are made on event day 0 after the close of the stock market. In these cases the effects will be captured in the return day 1.

As a general result, we find a two-days (0,1) excess return equal to -5,79% for the "New/Renewal" announcements, and a +7,75% for the "Termination" cases.

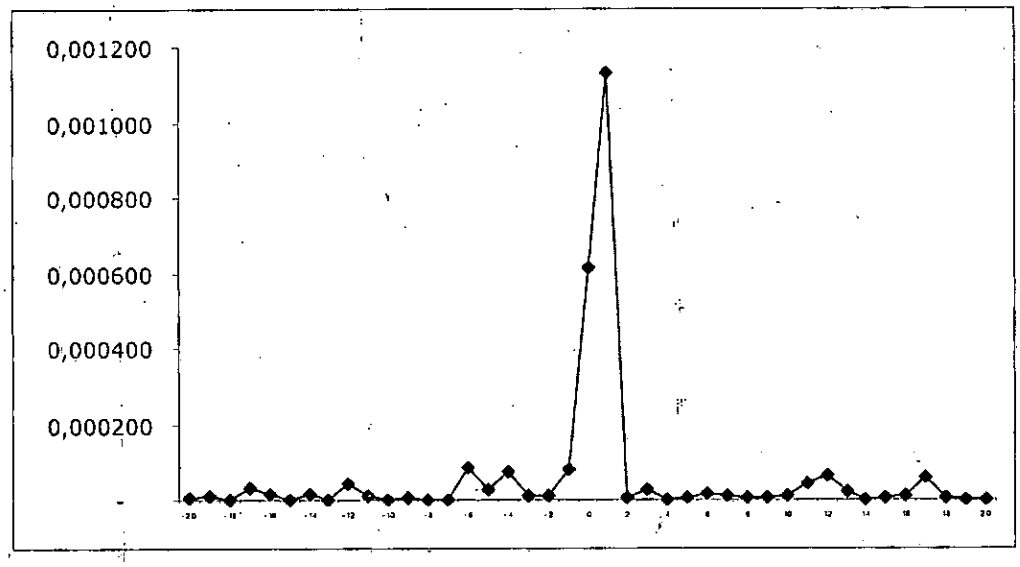
Table VII: Average and Cumulative Abnormal Returns

Event Day	New/Renewal (40 Announcements)		Termination (16 Announcements)	
	AAR	CAAR	AAR	CAAR
-20	0,00216	0,00216	0,00634	0,00634
-19	0,00304	0,00520	-0,00891	-0,00258
-18	0,00061	0,00581	0,01722	0,01464
-17	-0,00567	0,00014	0,00620	0,02084
-16	0,00417	0,00430	-0,00229	0,01855
-15	0,00126	0,00556	-0,00909	0,00946
-14	0,00368	0,00924	0,00170	0,01116
-13	0,00157	0,01081	0,00676	0,01792
-12	0,00653	0,01734	0,00069	0,01861
-11	0,00322	0,02056	-0,00225	0,01635
-10	0,00010	0,02065	-0,00643	0,00992
-9	0,00254	0,02320	0,00489	0,01481
-8	0,00120	0,02440	-0,00540	0,00941
-7	0,00006	0,02446	0,00511	0,01452
-6	0,00931	0,03377	-0,00817	0,00636
-5	0,00504	0,03880	-0,00941	-0,00305
-4	0,00860	0,04740	-0,00496	-0,00801
-3	0,00300	0,05040	-0,00296	-0,01097
-2	0,00307	0,05346	-0,00815	-0,01912
-1	0,00881	0,06227	-0,01444	-0,03356
0	-0,02477	0,03751	0,02832	-0,00524
1	-0,03359	0,00391	0,04941	0,04417
2	0,00240	0,00632	0,01059	0,05476
3	-0,00533	0,00099	-0,00967	0,04509
4	-0,00131	-0,00032	-0,00742	0,03767
5	0,00206	0,00174	-0,00878	0,02888
6	0,00389	0,00563	0,00251	0,03139
7	-0,00327	0,00235	-0,00232	0,02907
8	0,00210	0,00445	0,00082	0,02989
9	0,00262	0,00708	0,01334	0,04323
10	-0,00316	0,00391	0,00486	0,04809
11	-0,00636	-0,00245	-0,00061	0,04748
12	-0,00791	-0,01036	0,00023	0,04771
13	-0,00458	-0,01494	-0,00513	0,04258
14	0,00092	-0,01402	-0,00242	0,04016
15	-0,00182	-0,01584	0,00238	0,04254
16	0,00337	-0,01247	-0,00732	0,03522
17	0,00770	-0,00477	0,00456	0,03977
18	0,00282	-0,00195	0,00562	0,04539
19	0,00094	-0,00101	0,01051	0,05590
20	0,00123	0,00022	-0,00510	0,05080

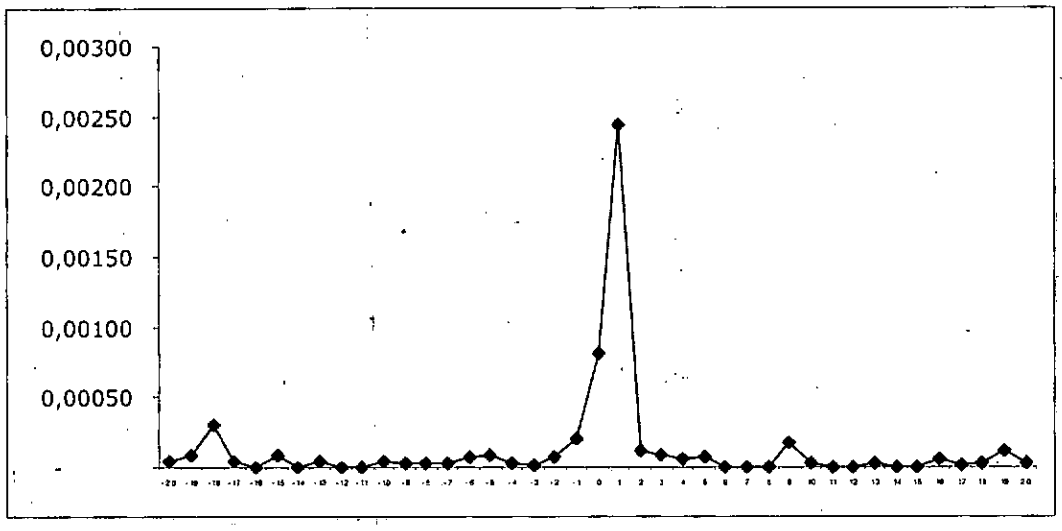
In order to fully appreciate the announcements effects along the event window, we report in Graph III and IV the shape of the squared abnormal returns. Both the

graphs show the relative magnitude of the announcement effects represented by a significant jump in the day 0 to day 1 interval.

Graph III: Squared Average Abnormal Returns for "New/Renewal" Announcements



Graph IV: Squared Average Abnormal Returns for "Termination" Announcements



Focusing on the day 0-1 interval, we test our null hypothesis that voting trusts' announcements do not have information content. As reported in Table VIII both the T-

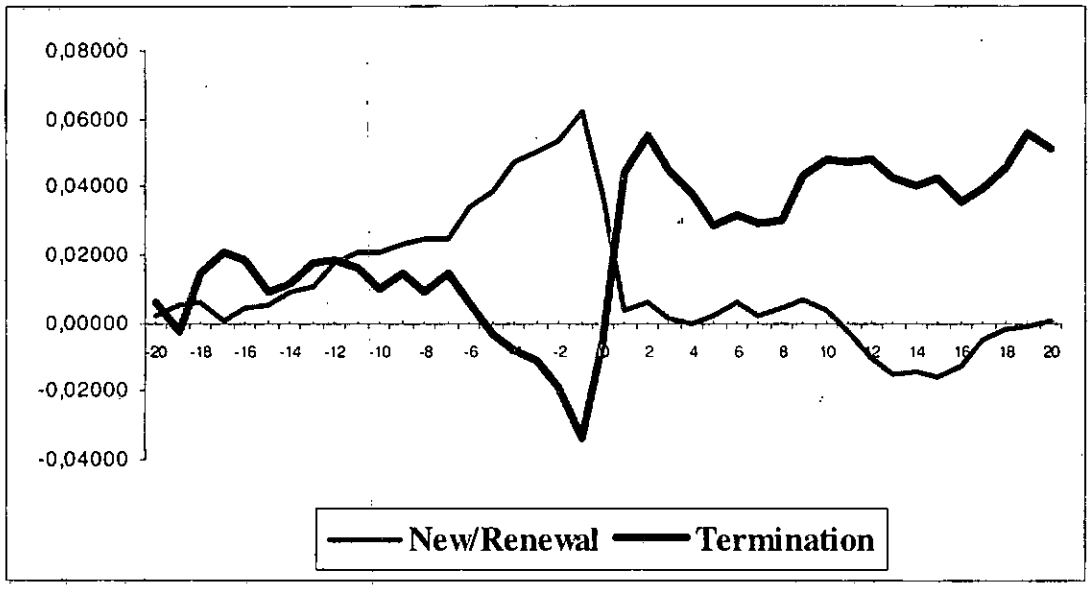
test and the Wilcoxon-Test, are statistically significant[59] in each case. Thus, the null hypothesis that voting trusts' announcements contain no information can be rejected.

Table VIII: Cumulative Average Abnormal Returns (0,1) for Voting Trusts' Announcements

	Announcements	Mean	Median	Standard Deviation	Min	Max	*t*-statistics	Wilcoxon Statistics
New/Renewal	*40*	-5.79%	-4,49%	4,47%	-20.08%	-0.60%	-8,190	-5,511
Termination	*16*	7,75%	6,50%	4,83%	1,44%	15,66%	6,408	-3,524

Finally, we plot simultaneously the cumulative average abnormal returns for the two different types of voting trusts' announcements. The CAAR plots show that the market, to some extent, reacts to the forthcoming earnings announcement and also reacts afterwards. But, it is worth to note that while in the case of "New/Renewal" announcements the effect is fully reabsorbed at the end of the period (Table on day +20 the CAAR is a negligible +0,01%), in the Termination case the CAAR ends with a +5,08%. That percentage could be interpreted as the "premium" the market assigns to firms which, after the termination of the voting trust, are more "contestable" than they previously were under the shared control of multiple large shareholders.

Graph V: Plot of Cumulative Market-Model Abnormal Return for Voting Trusts' Announcements



[59] At 5% level (two-tailed test).

3.5.2 *Non-Voting Shares*

We analyze separately the announcement effects on non-voting shares issued by the firms in our sample during the same event window[60]. It is worth to underline that non-voting shares listed on the Milan Stock Exchange are characterized by substantial illiquidity (Bigelli, 2003) due to the marginal role this class of stock is playing, in recent years, within the equity structure of Italian companies.

Anyway, we identify, among the events comprised in the sample, 24 announcements (19 "New/Renewal", and 5 "Termination") related to companies with listed non-voting shares. The results of the analysis are reported in Table IX, where we show the AAR and CAAR for the two samples.

As in the case of voting shares, we identify the market reaction in days 0 and 1, finding an excess cumulate return of -3,21% for the "New/Renewal" announcements, and +4,20% for the "Termination" cases. The sign of these market reactions are coherent with the previous findings about voting shares.

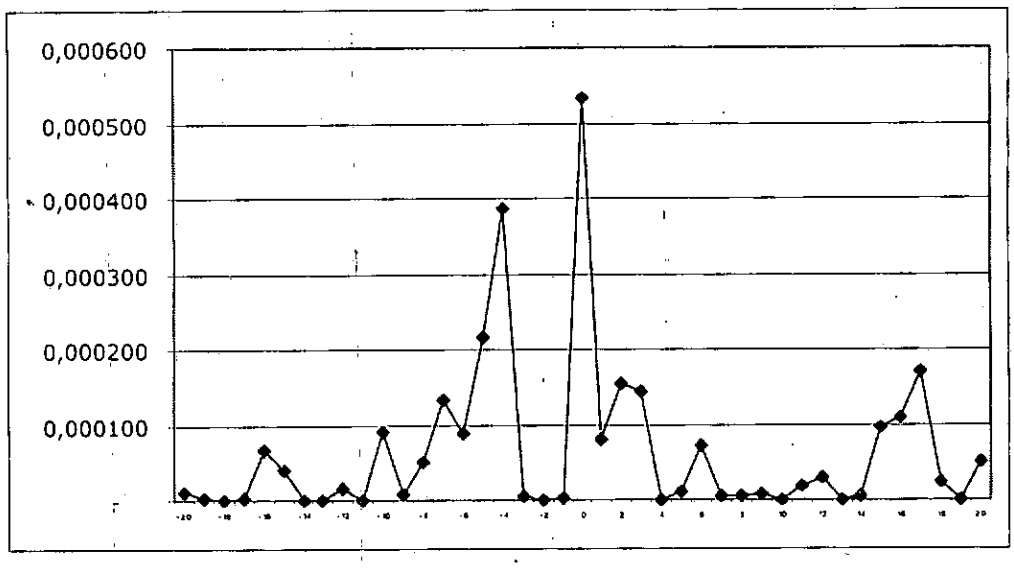
[60] We model the abnormal returns for non-voting shares, using a 250-days estimation window for each non-voting share included in the sample as explained in § 3.3.

Table XI: Average and Cumulative Abnormal Returns (Non-voting Shares)

Event Day	New/Renewal (19 Announcements)		Termination (5 Announcements)	
	AAR	CAAR	AAR	CAAR
-20	0,00339	0,00339	0,00648	0,00648
-19	0,00165	0,00504	-0,00277	0,00372
-18	-0,00078	0,00426	-0,00017	0,00354
-17	-0,00189	0,00237	0,00280	0,00635
-16	0,00817	0,01054	-0,00009	0,00625
-15	-0,00637	0,00417	0,00697	0,01322
-14	0,00008	0,00425	0,00877	0,02199
-13	-0,00113	0,00312	0,00775	0,02974
-12	0,00394	0,00706	0,01946	0,04920
-11	-0,00011	0,00695	-0,00039	0,04881
-10	0,00957	0,01651	-0,01068	0,03813
-9	0,00259	0,01910	0,00262	0,04075
-8	0,00706	0,02616	0,00537	0,04612
-7	0,01160	0,03776	0,00623	0,05235
-6	0,00939	0,04715	0,03697	0,08932
-5	0,01469	0,06184	-0,00471	0,08461
-4	0,01967	0,08151	0,00467	0,08929
-3	0,00205	0,08356	-0,01207	0,07722
-2	0,00106	0,08462	0,00096	0,07818
-1	0,00181	0,08643	-0,00280	0,07538
0	-0,02310	0,06332	0,03603	0,11140
1	-0,00899	0,05434	0,00598	0,11739
2	0,01247	0,06680	-0,01524	0,10215
3	0,01202	0,07882	0,00694	0,10909
4	0,00105	0,07988	-0,02368	0,08542
5	-0,00338	0,07649	-0,00617	0,07924
6	0,00843	0,08492	0,00190	0,08115
7	-0,00235	0,08257	-0,00429	0,07686
8	-0,00213	0,08044	0,00106	0,07791
9	-0,00302	0,07742	-0,00295	0,07496
10	0,00006	0,07748	0,00036	0,07532
11	-0,00424	0,07325	-0,00295	0,07237
12	-0,00535	0,06790	0,00859	0,08097
13	-0,00006	0,06784	-0,00781	0,07315
14	0,00218	0,07002	0,00370	0,07685
15	0,00976	0,07979	-0,00826	0,06859
16	-0,01048	0,06931	-0,00465	0,06394
17	0,01304	0,08234	0,00615	0,07009
18	-0,00499	0,07735	0,00979	0,07988
19	-0,00071	0,07664	0,00405	0,08393
20	0,00711	0,08375	0,00314	0,08707

Anyway, as both Graph VI and VII show the abnormal returns along the event windows are much more instable in comparison with voting shares.

Graph VI: Squared Average Abnormal Returns for "New/Renewal" Announcements (Non-Voting Shares)



Graph VII: Squared Average Abnormal Returns for "Termination" Announcements (Non-voting Shares)

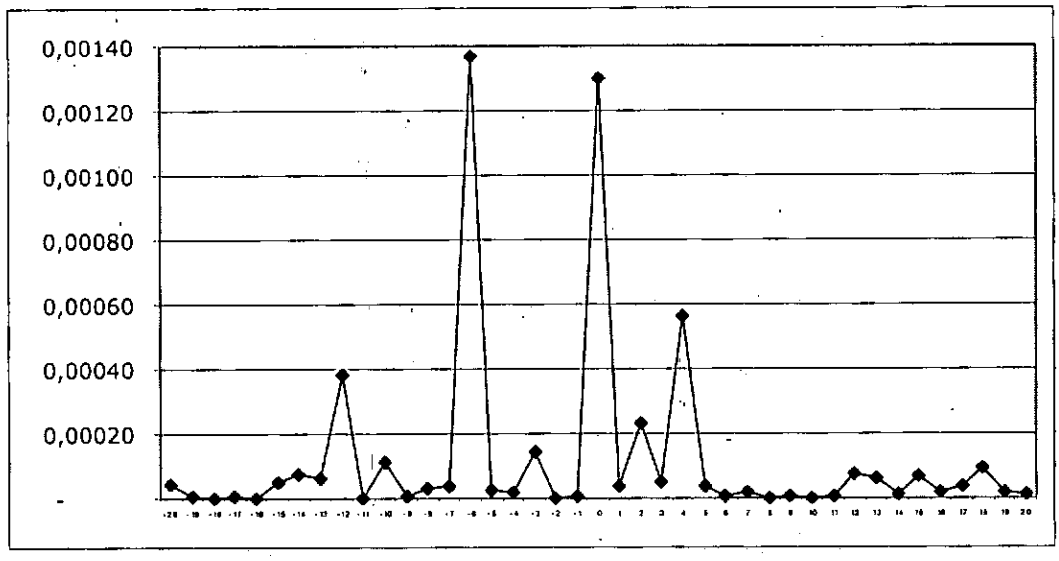


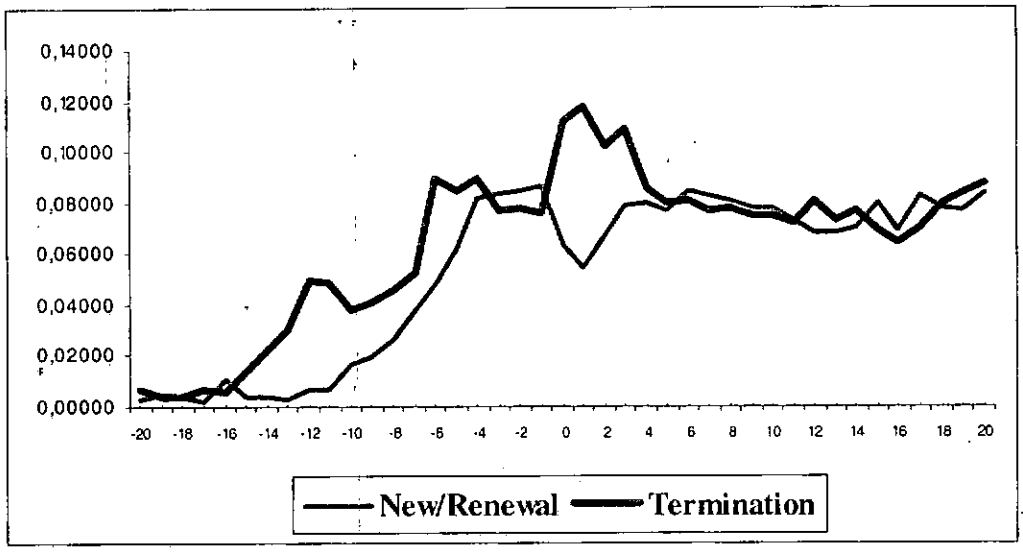
Table X summarizes the CAAR results about the effect of voting trusts announcement on non-voting sharers. While the "New/Renewal" sample is statistically significant (t=-2,958), the "Termination" case, especially due to the limited number of observations, is not significant (t=1,900).

Table X: Cumulative Average Abnormal Returns (0,1) for Voting Trusts' Announcements (Non-Voting Shares)

	Announcements	Mean	Median	Standard Deviation	Min	Max	*t*-statistics	Wilcoxon Statistics
New/Renewal	*19*	-3,21%	-2,84%	4,72%	-19,46%	1,48%	-2,958	-2,817
Termination	*5*	4,20%	2,70%	4,94%	0,10%	12,46%	1,900	-2,023

Finally, the plots of CAAR show a substantial learning effect for both the announcements' categories.

Graph VIII: Plot of Cumulative Market-Model Abnormal Return for Voting Trusts' Announcements (Non-Voting Shares)



3.6 Conclusions

While Italian voting trusts have been cited in the finance literature, at least, since early Nineties (Zingales, 1994) and they have been largely acknowledged to be a key mechanism within the ownership structure of Italian companies (La Porta et al., 1999; Volpin, 2002), to date, as far as we know, no study has specifically addressed the functioning mechanism of such a governance device.

Thus, this thesis is aimed at illustrating the rationale of voting trust. From the empirical evidence gathered in the previous chapter, we are able to formalize a simple model which shows how both the existence of private benefits of control and the separation between ownership and control attained through voting trusts, affect the dynamics of the market for corporate control of firms held by voting trusts.

We test the insights coming from the model by applying an event study analysis on a sample of voting trusts' announcements. We find statistically significant abnormal returns in both the event day and the following day. The sign of this cumulate reaction is negative for announcements of new/renewed trusts and positive in the cases of trusts' termination. Furthermore, there is some evidence about the persistence of stock price upsides at the end of the considered period, in the case of terminated trusts. This finding is consistent with the "entrenchment effect" originally modelled by Stulz (1988) linking the ownership structure and firm value. As a general result, the presence of multiple large shareholders, tied within a voting trust, is reflected in a lower valuation of the firm.

This study bears, at least, two limitations. The first relies on the small number of announcements included in the sample, especially in the case of voting trusts' termination. This is due to the unavailability of a reliable database containing voting trusts announcements before the 1995. The second weakness, strictly linked with the first one, is due to the fact that the data is not fully exploited since the significant cumulative average abnormal return in days 0-1 should be further analysed, in search

for the determinants of these market reactions (especially controlling for corporate performance, presence of large shareholder outside the trust, internal stability of the trust, etc.).

Anyway, as a specific implication arising from both our analysis and the brief case study we presented, we are able to cast doubts about the validity of the disclosure regime for voting trusts enacted by the 1998 Reform. Since we showed that voting trusts' announcements have information content, they probably should be regulated through the "price sensitive" framework, rather than according the lax Article 122. Moreover, following the SEC's approach, it should be consented to the public a wider and more rapid access to the integral text of pacts.

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