DYNAMICS OF CORPORATE GOVERNANCE REFORM IN EUROPE

Dan CHIRLESAN
Faculty of Economics and Business Administration
Alexandru Ioan Cuza University of Iasi
Iasi, Romania
danch@uaic.ro

Bogdan ILUT
Faculty of Economics and Business Administration
Alexandru Ioan Cuza University of Iasi
Iasi, Romania
ilut2k@yahoo.com

Abstract

Corporate governance represents a major topic in the field of economics. On the basis of literature written on this topic so far, this article presents the main characteristics of corporate governance in Europe and in the US. It then proceeds to present the problems that emerge as an effect of concentrated ownership, and draws on the Parmalat scandal as an illustrative case in point. Without claiming to be exhaustive, the paper finally emphasises the changes that are needed and that have been undertook in order to meet the challenges of European firms' corporate governance.

Keywords: Corporate Governance, Internal Governance, Disclosure, Private Enforcement, Public Enforcement
JEL classification: G18, G32, G34, G38

1. INTRODUCTION

If it were to identify the main problem of corporate governance in the US, we could easily identify it as the continuous conflict between dispersed small shareowners and powerful controlling managers. This subject is underlined and debated in classical works such as Berle and Means (1932) and Jensen and Meckling (1976). In reality, even if some American companies such as Ford, Wall-Mart or Microsoft, are characterised by a large number of shareholders, these companies are not a central focus in the debate regarding American corporate governance, as their number is rather limited (Anderson and Reeb, 2003).

If it were to compare them with companies from Europe or from the rest of the world, it becomes clear that the focus of the debate on corporate governance is different. Here, only a small portion of the listed companies have a large number of shareholders. By contrast, Europe and in general the rest of the world has listed companies that are held by a large shareholder, who is most of the times an individual or a family. Usually, this large shareholder controls the majority of votes, without owning a large fraction of the cash flow rights. This is possible because most of the times they employ pyramidal ownership schemes, shareholder agreements and/or a dual classes of shares (La Porta, Lopez-de-Silanes, and Shleifer, 1999).

These characteristics have two obvious consequences, as was showed in the works of Morck, Wolfenzon, and Yeung (2005). In the first place, the concentrated structure of ownerships enables shareholders to impose their objectives better that the ones of the management team. In the second place, this concentrated structure can lead and actually does lead to conflicts between shareholders, as the interests of the majority shareholder and the minority shareholders tend not to be aligned.

The main objective of this paper is to underline the characteristics of the three main economies of Europe: Germany, France and Italy, and to compare them with the ones from the United States. In order to achieve this we present the issues that tend to emerge in firms with a major shareholder. To better underline this approach we exemplify it with the Parmalat scandal which represents a good illustration for investor expropriation in a family-controlled listed firm. We give an overview of the legal instruments that can be used in order to better protect minority shareholders, and present the main reform in the field of corporate governance that have characterised the three major European economies between 1995 and 2009.

2. CONCENTRATED OWNERSHIP – A CHARACTERISTIC FEATURE OF EUROPEAN CORPORATE GOVERNANCE

In general in the field of corporate governance it is accepted that in order for a shareholder to be recognised as a major one it needs to own at least 20% of the voting rights of the company.

Table no. 1- The concentration of ownership of the main 20 largest firms listed on the main European countries and in the US at the end of 2008

	Widely held	*Family control*	*Pyramid control*	*Median largest voting block*	*Family wealth*
Germany	50%	10%	20%	57%	21%
France	60%	20%	15%	20%	29%
Italy	20%	15%	20%	55%	20%
United Kingdom	100%	0%	0%	10%	6%
United States	80%	20%	0%	5% (NYSE) 9% (Nasdaq)	N.A.

Source: based on dates provided by NYSE Euronext, Nasdaq OMX and LSE-Borsa Italiana

In Table 1 we have analysed the structure of ownership for the first 20 largest firms listed on the stock markets from the specified countries. In the first column, the percentages indicate how many companies are widely held, meaning that they do not have a major shareholder.

In the second column we can see how many companies are controlled by a family or an individual. It is obvious that the United Kingdom poses an interesting case because none of its major listed firms is held by a family or an individual. A pyramidal control holding scheme is the preferred way in which companies from Europe are held and owned. The basic idea behind the scheme is that the major shareholder control over the listed firm is held directly and also through at least another listed firm which held sufficient voting rights. We can see clearly that pyramidal schemes of control do not exist in the Anglo-Saxon firms, while in the rest of Europe it is a very popular tool for control. This is because, as the works of Morck and Yeung (2005) and Franks, Mayer, and Rossi (2005) suggest, the legislative regulations undertook in the 1935 in the US regarding taxation of intercompany dividends and the introduction of the mandatory takeover bid in 1968, had a diminishing effect on the use of this type of schemes in these countries.

3. CORPORATE GOVERNANCE IN FAMILY CONTROLLED FIRMS - THE CASE OF PARMALAT

On average, it is estimated that family-controlled firms are better managed than widely held firms. One index that has been used to evaluate efficiency of management is Tobin's q. This is the ratio of the market value of a firm to the replacement value of its assets, which is generally quantified as the book value of the firm's assets. In any analysis of Tobin's q statistics, a higher (industry-adjusted) value of Tobin's q indicates that the assets are used efficiently, i.e. they are worth more within the firm than in any other use.

In a sample of large North American companies, Anderson and Reeb (2003) noticed that there was a significantly higher Tobin's q for family-controlled firms (a third of firms in their sample) than for widely held companies. Barontini and Caprio (2005) reached a similar result in their research on European companies. Of course, one should not directly infer that family-controlled firms are always better governed than widely held ones. Family control is indeed instrumental in protecting shareholders' interest against managerial abuses: in most cases, the controlling owner and the manager are the same person. Moreover, the controlling family will probably invest more human capital in the firm and will be more interested in its long-term value (Bertrand and Schoar, 2006). However, families, just like managers in a widely held company, can abuse their power so as to put corporate resources to their own advantage.

When this occurs in a family-controlled firm, the situation is definitely worse than in a widely held company, since controlling families cannot be eliminated from the company through a hostile takeover, nor can they be replaced by the board of directors or by the shareholders' meeting.

Another important concept that is worth mentioning is self-dealing or tunnelling. It refers to the transfer of value from firms controlled by a shareholder who owns a small fraction of the cash-flow rights (lower down in the pyramid), to firms whose controlling shareholder is in possession of a large fraction of cash-flow rights (higher up in the pyramid) (Johnson, La Porta, Lopez-de-Silanes, and Shleifer, 2000). One can transfer value in many ways: related-party transactions (transactions with the controlling shareholder, a director, or third parties associated with them); the biased allocation of intangible assets and liabilities; exceedingly high director compensation; and many others.

In what follows, we shall provide a hypothetical example that will assist us in clarifying how tunnelling works. Starting from the pyramidal group, let us imagine what were to happen if Marco Tronchetti Provera forced Telecom Italia to buy inputs from Camfin at above-market prices. This type of related-party transaction does not create value, not does it destroys value; this is so because the loss incurred by Telecom Italia equals the gain registered by Camfin. Yet, in this scenario, Tronchetti Provera would end up in a better position because he gains 29.1 percent of Camfin's gain and experiences only 0.7 percent of Telecom Italia's loss.

The power available to a controlling shareholder to use corporate resources for private advantage can equally impact the value of a company for the controlling shareholder and for the other (minority) shareholders. Specialists refer to this difference in value as the private benefits of control. They are empirically exemplified by the "block premium," which refers to the difference between the price per share that is paid in a block transaction, and the market price after the transaction.

To come now to the case of Parmalat proper, this is a very illustrative example of corporate governance abuses in insider-dominated countries. Our analysis and interpretation of the scandal draws on Ferrarini and Giudici (2005). The story began when Calisto Tanzi inherited a small family business in the 1960s and the firm began registering an ever-accelerating growth. In 1989 it was listed on the Milan stock exchange. At the time, Parmalat Finanziaria was the holding company of a group that counted 58 companies (out of which 33 were not based in Italy) with aggregate sales of $720 million. The Tanzi family was the controlling shareholder through a non-listed company. The company's acquisition drive became even more acute in the 1990s, with aggregate sales reaching $3.6 billion in 1996 and almost $10 billion in 2002.

Most of the group's expansion was on the milk and dairy products market, especially in South America. But the Tanzis also diversified their product portfolio and went outside the food industry, mainly into soccer - the pet project of Calisto Tanzi's son Stefano -, and tourism, the pet project of Tanzi's daughter Francesca. Most of the new acquisitions were financed with debt. The peculiar characteristic feature of Parmalat's balance sheet was the co-occurrence of high levels of debt and cash. In 2002, the annual report indicated $4.3 billion in cash and equivalent, against a $9.3 billion of debt. The cruel reality was that most of the reported cash had long been consumed.

Tanzi's empire came to an end in December 2003. After a few failed attempts to refinance its debt, on the 8th of December Parmalat admittedthat it could not repay bonds that were maturing. Immediately after the bonds' downgrade to junk level, the share price collapsed too. In parallel, Consob (the Italian Securities and Exchange Commission) demanded proof of the existence of a bank account with Bank of America where, via a Cayman Islands company called Bonlat, the $4.3 billion of Parmalat's cash was allegedly deposited. Bank of America soon promptly replied that there was no such account. As a result, Parmalat Finanziaria was declared insolvent, while Calisto Tanzi was convicted to jail.

An estimate of the sources and uses of funds, from 1990 to December 2003, showed that the Parmalat group spent a total of $18.2 billion of financial resources, including $16.9 billion raised from debt. During the same period of time, the family siphoned off about $3 billion. Most of these resources had been transferred to other businesses directly owned by the Tanzi family. It turned out that the techniques used to conceal the fraud were rudimentary, and numerous: Parmalat hid losses, overstated assets as well as recorded nonexistent assets in the company's lodgers; on the other hand, it understated debt, falsified bank documents, and diverted cash to the Tanzi family.

As in any other significant financial scandal, the designated watchdogs (auditors, investment banks, and regulators) are liable, in part, for failing to detect on time the patterns of negligence, fraud, and corruption. However, Parmalat is an example of sheer expropriation of shareholders and creditors alike by a family that used company resources as their own.

Financial scandals in companies defined by concentrated ownership, like Parmalat, usually differ from those that have diffused ownership, like Enron and Worldcom. In the case of Enron and Worldcom (as well as in Vivendi and Royal Ahold, two European widely held companies), their corporate managers manipulated earnings and made accounting irregularities so as to inflate the stock price and profit from their equity and options holdings. In the case of Parmalat (as well as in the case of Adelphia, a U.S. company with concentrated ownership), the controlling shareholders expropriated corporate resources by self-dealing. These differences – it has been argued - should lead to different regulatory response-measures in different countries (Coffee, 2005).

4. STEPS TOWARD THE REFORM OF CORPORATE GOVERNANCE IN FRANCE, GERMANY AND ITALY

The last two decades have been the scene to some grate reforms in order to improve internal governance, empower shareholders, enhance disclosure and strengthen public enforcement in countries like France, Germany and Italy. In order to underline the progresses made it is helpful to make some comparison with the United States.

In contrast with the United States where the directors are making almost all the decisions (or are having exclusive power to initiate some of them if a shareholder vote is mandated), in Europe, the shareholders tend to have the final vote on a large number of problems like share buy-backs, new issues or dividend payments. Also, in Europe, shareholders are having enhanced powers in order to set the meeting agenda (Cools, 2005). This way of power allocation is in line with the prevailing ownership structures, both in United States and Europe, granting the controllers the right and the methods to exercise and maintain control (the management in the US and respectively the shareholders in Europe).

In the United States the government has a long tradition and a more important role in the regulation of corporate governance, than the European Community has. In the United States the regulation of securities was developed since 1930 and provides insight on many crucial corporate governance problems like shareholders meetings and voting, insider trading, securities fraud and takeovers. With the adoption of the Sarbanes–Oxley Act even the composition and functioning of boards is regulated (Roe, 2003). By contrast, in Europe, despite the extended powers that the European Community has on corporate law issues, traditionally, we can observe that the regulation and the impact of the European initiatives had a rather lower impact on European company’s corporate governance (e.g. see Enriques, 2006).

In addition to this, the United States securities regulations and laws are enforcing a mandatory system for the disclosure of information’s which is more comprehensive than its European counterpart. This system is effective because of the many enforcement institutions that are supervising it, like the securities plaintiff bar, the Securities and Exchange Commission or the United States Department of Justice. In the European Union, the enforcement of corporate laws are handled by the member states, which tend to be far less aggressive in handling violations and breaches of the corporate and securities laws via public enforcement. Moreover, in the United States, corporate directors also face a high risk of being sued if they engage in self dealing.

Even if the European corporate governance systems myth seam similar when compared with the situation in the United States but each one has distinctive characteristics, that fragmentise even more the European corporate government landscape.

For example, the German corporate governance law requires a two-tier board structure which is composed from a “supervisory board” and a “managerial board”. In another train of thoughts, German companies which have more than 2000 employees must have a supervisory board composed by an equal number of shareholders elected and employees chosen members (the so-called “co-determination” by the academic literature). Another particular aspect of German corporate governance is represented by the central role that banks are playing in the supervisory boards of German listed companies, based on the holdings that the banking institutions are traditionally having in these companies. Despite these characteristics, it has been proven that boards composed by banks and employees representatives are as inefficient as any other boards in supervising the management and the dominant shareholders (Theisen, 1998).

In another train of thoughts, in France, the managerial attributes have been historically concentrated on the hands of the chief executive officer who also acts as the chairman of the board. In this respect, the French corporate governance laws have been friendlier to minority shareholders that in the case of Germany or even Italy. For example, individual shareholders have had a better opportunity to sue directors for misconduct activities, while trading among board members has been specially revised so that these transactions must be approved by both the board and the shareholders, excepting the case where they represent “*routine current transactions entered into at normal conditions*”. Traditionally courts have ruled mildly in these cases, considering transactions among companies from the same group as routine transactions (see Enriques, 2004).

Nevertheless, in Italy, the internal audit of a firm has been carried out by a separate body of auditors, which is composed exclusively by independent members (at least formally). Despite this, neither the board or the auditors have ever been able to effectively and efficiently control the Chief Executive Officer and the managerial team (ergo the dominant shareholder who has appointed them), a good example in this case being illustrated by the Parmalat scandal. In a broad perspective, the Italian corporate governance law has historically been unable to provide adequate protection for investors. Moreover, enforcement institutions like the Consob (the Italian Securities and Exchange Commission) or the courts of law have been rather unable to compensate for the deficiencies of the law (for an extended overview of these situations see Aganin and Volpin, 2005).

In the last three decades the corporate governance reforms in Europe have been driven by at least three major factors. On the one hand, the reforms undertaken regarding corporate governance laws have aimed at making national capital markets more attractive to outside investors taking in to account the fearful international competition for equity capital, the deregulation and globalisation process and nevertheless the massive privatisation that have been done in this period (Kamar, 2006). On the other hand, these changes have been encouraged by the European Commission’s undertakings and efforts to provide a common regulatory framework for all the Union regarding financial transactions, especially in regard to disclosure issues (see Ferran, 2004 and Enriques and Gatti, 2006). Nevertheless, especially in the last period, some reforms have been undertaken as a backlash to series o corporate scandals (e.g. Metallgesellschaft in Germany, Enron in the US, Parmalat in Europe, Worldcom in US) which stunt the financial world (see Enriques, 2003 and Cioffi, 2002 for a wider description).

4.1. THE STRENGTHENING OF THE INTERNAL GOVERNANCE ACT

As a result of the big corporate scandals from the beginning of the new millennium, the US Congress and the main American stock exchanges, NYSE and NASDAQ, have developed s series of rules and regulation in order to ensure the soundness of the corporate governances process, which require that the majority of the majority of the top management be appointed independently and also that every listed firm has a adequate and independent internal audit mechanism in place. Moreover, the independent characteristics of the audit board have been enhanced and also its abilities to enforce regulation and decisions over the management. Nevertheless, there have been also attempts to discourage self-dealing by imposing that listed firms have a completely independent compensations committee and that chief executive officers and top management members are forbidden from receiving loans from the firms which they administrate. *By contrast, none of the European countries form our panel has ever taken such drastic measures for straitening the corporate governance act and mechanisms*. In table two, we have summarised the main undertaking by the European countries in our panel regarding the improving *board effectiveness* and discouraging the self-dealing activities of the board members.

In this regard, in Germany, the 1998 corporate governance reform aimed to redefine the functions of the managerial board and also of the supervisory body. As a result of these undertakings the managerial board must report to the supervisory body regarding several issues like: risk management, budget and business plans. Also, the supervisory body must have at least four annual meetings and has an enhanced role in the selection and the relationship of the auditors.

Table no. 2 - Measures taken to strengthen the internal governance act in France, Germany and Italy between 1995 and 2009

France	*Germany*	*Italy*
	Improvement of Board efficiency	
The separation of the Chairman and the CEO positions (*starting 2000*).	Enhancement of the role of the supervisory board (*starting 1998*).	New rules regarding the dissemination of information for the board of directors (*reforms undertaken in 1998 and 2003*).
Improvement of the regulations regarding the dissemination of internal information (*reforms undertaken in 2000 and 2003*).	Reform of specific duties regarding of risk management and internal control of the board of directors (*starting 1998*).	The granting of minority shareholders to be represented in the board of directors (*starting 2005 and*) and in the auditors board (*starting 1998*)
		Increased powers granted to the boards of auditors and the enhancement of its independent character (*reforms undertaken in 1998 and 2005*)
	Anti self-dealing measures and regulations	
Improvement of the non-routine transactions disclosure undertaken by board members in self-dealing transactions (*reforms undertaken in 2001, 2003 and 2005*)		The improvement of board disclosure and related self-dealing activities by the board members (*starting 1998*)

Source: own compilation based on legislative acts adopted in France, Germany and Italy in the analysed period

In another train of thoughts, the French corporate governance law does little in regard to the enhancement of the powers of the board of directors, stipulating only the separation between the position of the chairman of the board and that of chief executive officer. There have been also some incentives regarding the information of the directors from sources outside the firm. According to the law adopted in 2001, directors can require and receive all the information's they need in order to carry out their duties (for a full brief on this reform see Menjucq, 2005). But, an amendment made two years later to this law prevented individual board member form directly accessing the firm documents.

Nevertheless, in Italy, the legislative reform has enhanced the internal governance act stating that chief executive officers must inform the board of directors regularly, while also at least one member from the board of directors and the auditors' board must be appointed by minority shareholders. The reforms undertaken also strengthen the authority and attributes of the board of auditors enhancing it independent characteristics.

On the same idea, France and Italy have both enhanced the self-dealings regulations regarding majority shareholders transactions. In France for example, the transactions undertaken by shareholders who owned more that 10 percent and also by directors as part of their compensations packages have been considered "special regime transactions". Also, in Italy, the formal lax regime law on self-dealing transactions has been strengthening. Based on this new law, the managers must disclose to the whole board of directors and also to the board of auditors every direct and indirect interest that they may have on a given transaction. If the chief executive officer holds an interest in a given transaction it is required a special approval by the board of directors. In the same train of thoughts, even if an implicated director is not forbidden to vote for a specific transaction, the board must provide the adequate arguments in favour of this transaction, underling the direct benefits for the firm. These mandatory explanations must be more detailed and analytical if the transaction is done between a firm and its parent corporation. In contrast to these reforms, in Germany there has been not a single initiative to enhance the internal governance act in the last fifteen years.

4.2 ENHANCING THE POWERS OF THE SHAREHOLDERS

If we analyse the American shareholder we can see that it has become more powerful. The main American stock exchanges, NYSE and NASDAQ, have both amended their regulations in order to require listed firms to obtain the approval of their shareholders in order to grant compensation plans for their managers. Moreover, brokers are forbidden to vote in their clients name in this regard, except the case in which they were instructed to do so by the client (see Klingsberg, 2006 and Bainbridge, 2006 for an extensive view on this matter).

In this regard, in continental Europe, lawmakers had various attempts to enhance the powers of the minority shareholders in regard to the powers of the management and the majority shareholders. These initiatives have been summarised in table three.

Table no. 3 - Steps toward the enhancing the powers of shareholders undertaken by France, Germany and Italy between 1995 and 2009

France	*Germany*	*Italy*
	Improvement of the voicing of opinions for the shareholders	
Non-routine transactions and compensation plans must be ratified by the annual meeting of the shareholders (*reforms undertaken in 2001, 2003 and 2005*).	The exercitation of the voting right was made easier (*starting 2001*).	Shareholders must approve the compensation plans (*starting 2005*).
The exercitation of the voting right was made easier (*starting 2001*).	The enhancement and facilitation of communication among shareholders (*starting 2005*).	The exercitation of the voting right was made easier (*starting 2003*).
Lowering of the threshold for minority shareholders (*starting 2002*)		The necessity for a qualified majority in order to adopt major resolutions was instated (*starting 1998*)
		Lowering of the threshold for minority shareholders (*reforms undertaken in 1998 and 2005*)
	Instating the law of one share one vote	
	The banning of share with multiple votes and the curving of the banks influence in the board of directors (*starting 1998*)	The banning of share with multiple votes (*starting 2003*)
	The exemption from taxation of corporate shareholdings sales (*starting 2002*)	The exemption from taxation of corporate shareholdings sales (*starting 2003*)
	Enhancement of private enforcement	
Shareholders already had the right to use derivatives lawsuits	Facilitation of civil lawsuits against securities fraud (*2003*)	Facilitation of derivative lawsuits for shareholders owing at least 2,5% (*reforms undertaken in 1998 and 2005*)
	Facilitation of derivative lawsuits (*starting 2005*)	

Source: own compilation based on legislative acts adopted in France, Germany and Italy in the analysed period

As an effect of the reforms undertaken, shareholders have now the power to authorize and regulate in regard to some transactions which are posing a high degree of possible conflicts of interests. As we can see from the table above, in France for instance the general meeting can ratify every non-routine transaction in which a major shareholder is involved and also in regard to the compensation packages which are granted to the top management. In Italy, on the other hand only the compensation packages based on stock options require approval from the assembly.

In every country from our panel shareholders are facing now lower cost for voting than in the ’90. Moreover, firms are allowing remote votes to be casted via IT&C technologies (e.g. Internet and telephone voting). In this respect, France and Germany have taken the necessary legislative steps in order to ensure the dissemination of information prior to the voting process for the shareholders which are abroad.

In regard to the need for the share to be deposited prior to the voting to a bank by the shareholders there is no unanimous approach in the three countries from our panel. Although, several steps have been undertaken to diminish the period required by law in which the shares are deposited before the actual vote, internal regulations of each firms tend to circumvent these laws. For instance in Germany there is no such a requirement instated by law where in France and Italy there is a 24 hour period before the vote when the share must be in the custody of a bank.

In order to limit the powers of the majority shareholders, there have been several check and balances mechanism put in place by the corporate governance law, especially in France and Germany, where a qualified majority is required in order to adopt certain decisions. By contrast in Italy, only since 1998, there has been a law which enforce a 2/3 majority for the adoptions of decisions regarding new issues, mergers and amendments to internal regulations. The aim of these check and balances systems is to allow minority shareholders the upper hand and thus a better control of the actions undertaken by the majority shareholders. Also in this regard the limits for minority shareholders rights have been reduced, allowing them to call a meeting if they held at least 5% of the shares in France and 10% in Italy, while in order to appoint an expert which will review certain transaction a shareholder needs to own at least 5%, this rule being valid in both countries.

In regard to the rule of one share one vote, Germany is by far the most aggressive country form the three which we have examined in enforcing this stipulation. It has banned multiple voting rights for a single share since 1998 and has forbidden banks to act as client proxy if they owned more that 5% of the shares of the firm in question. It also has enhanced the laws which discourage banks to vote in their clients name and thus support the managerial team of a firm. Moreover in 2002 a revision of the fiscal code was undertaken in order to exempt from taxation capital gains from the selling of shareholdings by corporations. This reformed aimed at encouraging firms to dissolve their cross-holdings of shares and sale them in to the market. Italy followed the pattern and revised its fiscal code in 2003 to allow the same breaks from taxation. In practice, these measures had a different effect for the two countries. While in Germany it provided an incentive to diminish the corporate block-holdings, a process which manifested well before the tax break, in Italy the effect was reverse, and as a result of the reform undertaken the percentage of cross-holdings of shares between Italian firms has raised (see Fohlin, 2005 and Bianchi and Bianco, 2006).

Italy also tackles the problem of one vote one share through a legislative reform of the corporate governance law – the so called "Draghi Law" adopted in 1998. Through this law the agreements between shareholders which created the large black-holdings which characterised the large listed Italian firms had to be revised every three years and thus allowing any shareholder which entered such a scheme to reconsider its position every three years. In another train of thoughts, in the case of a takeover bid, every shareholder had the opportunity according to this law to manage and negotiate its own position despite its involvement in such block-scheme, which provided a much needed flexibility for the merger and acquisition process of Italian firms.

Nevertheless, the private enforcement mechanism has been enhanced through some legislative initiative in Germany and Italy, which allowed a more facile procedure for derivative lawsuits, in other words, shareholders were facilitated to take actions in the name of the firm against self dealing directors and managers.

5. CONCLUSIONS

Corporate governance in continental Europe traditionally is different than North American governance in two important ways: first, most European companies have controlling shareholders, whereas most American companies are widely held; second, the regulations on self-dealing have traditionally been stricter in the United States.

Over the last 15 years, France, Germany, and Italy have designed and implemented significant corporate law reforms so as to strengthen the mechanisms of internal governance, empower shareholders, enhance disclosure requirements, and ensure public law enforcement. Special emphasis was laid on empowering minority shareholders and on disclosure - the most effective tools to counter abuses by dominant shareholders.

However, before concluding that the reforms have benefited investors, we should mention a few words of caution. First, extremely little has been done to solve the problem of related-party transactions, which is, unquestionably, the most frequent form of self-dealing for dominant shareholders in Europe. Germany has taken no step improve its law on this matter. France and Italy have introduced stricter rules on such transactions but they lag behind strengthening private enforcement - an absolute necessity to lend them effectiveness in the real world.

Second, a large percentage of the European reforms have been inspired by U.S. corporate and securities laws. America, indeed, has a well-developed corporate government legal framework, which has been even further improved by post-Enron reforms. Yet, since there are fundamental differences in ownership structure between Europe and North America, emulating laws focused on curbing managerial opportunism may not be the best solution to prevent self-dealing by controlling shareholders. Indeed, a cynical argument could be that when European policymakers trans-late and trans-pose U.S.-style solutions designed to tackle managerial agency problems, they may seem to be working towards the reform of European corporate governance but they actually leave the rents of Europe's dominant shareholders intact.

In light of its recent evolution, corporate governance law in Europe is often referred to as being in a "state of permanent reform". However, reforms further need to be created and enforced if continental Europe is to be effective in addressing the basic problems of corporate governance that are posed by the power of dominant shareholders.

References

[1] Aganin, A., Volpin, P., "The History of Corporate Ownership in Italy" in „*A History of Corporate Governance around the World*", ed. Randall K. M., p. 325–361, The University of Chicago Press, Chicago and London, 2005.

[2] Anderson, R. C., Reeb D. M., "Founding Family Ownership and Firm Performance", *Journal of Finance*, no. 58 / vol. 3, p. 1301–1328, 2003.

[3] Bainbridge, S. M., 2006. "Director Primacy and Shareholder Disempowerment", *Harvard Law Review*, no. 119 / vol. 6, 1735–1758, 2006.

[4] Barontini, R., Caprio, L., "The Effect of Family Control on Firm Value and Performance. Evidence from Continental Europe", *ECGI Finance Working Paper*, no. 88, 2005.

[5] Berle, A., Means, G., *The Modern Corporation and Private Property*, Macmillan, New York, 1932.

[6] Bertrand, M., Schoar, A., "The Role of Family in Family Firms", *Journal of Economic Perspectives*, no. 20 / vol. 2, p. 73–96, 2006.

[7] Bianchi, M., Bianco, M., "Italian Corporate Governance in the Last 15 Years: From Pyramids to Coalitions?", *ECGI - Finance Working Paper*, no. 144, 2006.

[8] Cioffi, J. W., "Reforming Germany Inc. - The Politics of Company and Takeover Law Reform in Germany and the European Union", *Law & Policy*, nr. 24 / vol. 4, p. 355–402, 2002.

[9] Coffee Jr., J. C., "A Theory of Corporate Scandals: Why the U.S. and Europe Differ", *Oxford Review of Economic Policy*, no. 21 / vol. 2, 198–211, 2005.

[10] Cools, S., "The Real Difference in Corporate Law between the United States and Continental Europe: Distribution of Powers", *Delaware Journal of Corporate Law*, no. 30 / vol. 3, p. 697–766, 2005.

[11] Enriques, L., "Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms", *Wake Forest Law Review*, no. 38 / vol. 3, p. 911–934, 2003.

[12] Enriques, L., "Book Review: The Comparative Anatomy of Corporate Law", *American Journal of Comparative Law*, no. 52 / vol. 4, p. 1011–1036.

[13] Enriques, L., "EC Company Law Directives and Regulations: How Trivial Are They?", *University of Pennsylvania Journal of International Economic Law*, no. 27 / vol. 1, p. 1–78, 2006.

[14] Enriques, L., and M. Gatti, *EC Reforms of Corporate Governance and Capital Markets Law: Do They Tackle Insiders' Opportunism?*, 2006, at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=886345, accessed on 1st January 2009.

[15] Ferran, E., *Building an EU Securities Market*, Cambridge University Press, Cambridge, 2004.

[16] Ferrarini, G. A., Giudici, P., "Financial Scandals and the Role of Private Enforcement: The Parmalat Case", *ECGI Law Working Paper*, no. 40, 2005.

[17] Fohlin, C., "The History of Corporate Ownership and Control in Germany" in *A History of Corporate Governance Around the World,* ed. Morck, R., K., p. 223–277, The University of Chicago Press, Chicago, 2005.

[18] Franks, J., Mayer, C., Rossi, S., "Spending Less Time with the Family: The Decline of Family Ownership in the United Kingdom" in *A History of Corporate Governance Around the World,* ed. Morck, R., K., p. 581–607, The University of Chicago Press, Chicago, 2005.

[19] Jensen, M., Meckling, W., "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure", *Journal of Financial Economics*, no. 3 / vol. 1, p. 305–360, 1976.

[20] Johnson, S., La Porta, R., Lopez-de-Silanes F., Shleifer, A., "Tunneling", *American Economic Review Papers and Proceedings*, no. 90 / vol. 2, p. 22–27, 2000.

[21] Kamar, E., "Beyond Competition for Incorporations", *Georgetown Law Journal*, no. 94 / vol. 6, 1725–70, 2006.

[22] Klingsberg, E., "New Court Decisions, Regulatory Positions and Legislation Provide New Tools for Stockholder Activists: Increases in Stockholder- Adopted By-laws and Proxy Contests on the Horizon", *Cleary Gottlieb M&A and Corporate Governance Report*, September 2006.

[23] La Porta, R., Lopez-de-Silanes F., and Shleifer, A., "Corporate Ownership Around the World", Journal of Finance, no. 54/ vol. 2, p. 471–517, 1999.

[24] Menjucq, M., "The Company Law Reform in France", Rabels Zeitschrift fur auslandisches und internationales Privatrecht, no. 69 / vol. 4, p. 698–711, 2005.

[25] Morck, R., Wolfenzon D., Yeung, B., "Corporate Governance, Economic Entrenchment and Growth", *Journal of Economic Literature*, no. 43 / vol. 3, p. 655–720, 2005.

[26] Morck, R., Yeung, B., "Dividend Taxation and Corporate Governance", *Journal of Economic Perspectives*, no. 19 / vol. 3, p. 163–180, 2005.

[27] Roe, M. J., "Delaware's Competition", *Harvard Law Review*, no. 117 / vol. 2, p. 588–646, 2003.

[28] Theisen, M. R., "Empirical Evidence and Economic Comments on Board Structure in Germany" in *Comparative Corporate Governance: The State of the Art and Emerging Research*, ed. Klaus J. H., Kanda, H., Roe, M. J., Wymeersch, E., Prigge, S., p. 259–265, Oxford University Press, Oxford, 1998.