# REVOLUTION IN ITALIAN COMPANIES OWNERSHIP STRUCTURE

## Moving towards a new spectrum of shareholder engagement

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CGLytics

Next generation governance analytics

## INTRODUCTION

Italy has been well known for its 'Relational capitalism', where most of the large companies are controlled by a network of families through cross-holdings and pyramidal ownership structures. According to OECD's Corporate Governance Fact-book 2017, nearly two-thirds of listed companies in Italy are controlled by a single shareholder. In 2012, Italy's cross-holding was in the spotlight as new rules we introduced. These were aimed at weakening the country's corporate culture where a group of top bankers and business people could link themselves through cross-shareholdings. With these links, they would defend themselves from outsiders and aid each other to grow. The new measure which was introduced by Mario Monti, the then technocratic prime minister, and upheld by the Bank of Italy, made it illegal for one person to hold more than one Board seat in a financial institution operating in the same sector or market. Several studies have shown that cross shareholdings are detrimental to minority shareholders. This is because it allows principal investors who sit on one another's boards to usurp funds by procuring access to finance beyond their credit means as a result of their close relationships.

***The financial crisis and rise of institutional shareholders have undermined those families' grasp on the Italian economy.***

In 2007, regulators introduced proxy access rules called 'Voto di lista' mechanism to limit the power of controlling shareholders. Voto di lista is a compulsory mechanism where shareholders vote on slates of nominees, which are submitted by both controlling shareholders and minorities. In this mechanism, at least one of the directors should be elected from the list given by the minority shareholders. Even though the voto di lista tries to protect minority shareholders by having at least one of their appointees in the Board, at the end of the day, it is the voting rights that rule the company.

In 2014, the Italian government introduced loyalty shares scheme which allows listed companies to grant double voting rights without corresponding economic exposure to shareholders that have owned their shares for at least two years (art. 127-quinquies of the Consolidated Financial Law). A simple majority vote is required at a special meeting to allow the company to introduce loyalty shares. The purpose of these loyalty shares is to encourage long-term shareholders and prevent short-termism. France has had a similar loyalty shares scheme for years. Controlling shareholders are the one who takes the most advantage out of it, by doubling their voting rights at shareholder meetings.

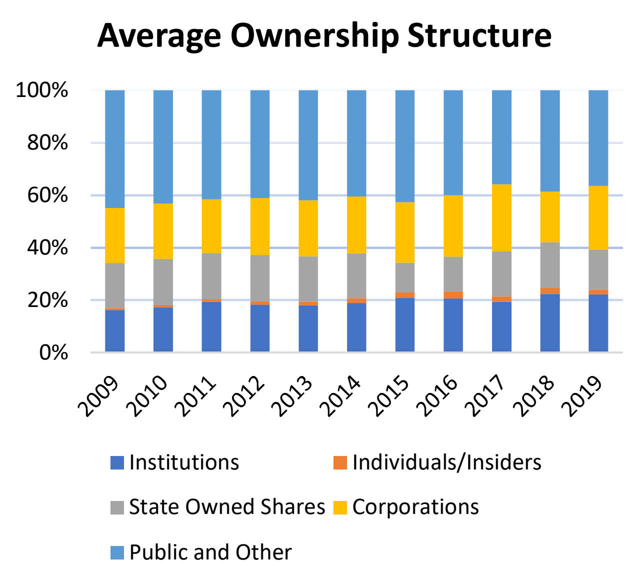
***Since most companies in Italy have a controlling shareholder, protection for minority shareholders has always been a challenge.***

## OVERALL OWNERSHIP STRUCTURE

Research performed by CGLytics shows a vast reform in the FTSE MIB, Italy's largest companies', ownership structure over the last 10 years. In 2009, 62.58% of the average ownership structure was held by public and others (including families). The percentage shares owned by them decreased at a steady pace over the period. In 2017, public and others held an average of 48.91% of company shares across the FTSE MIB representing 4.43% decrease.

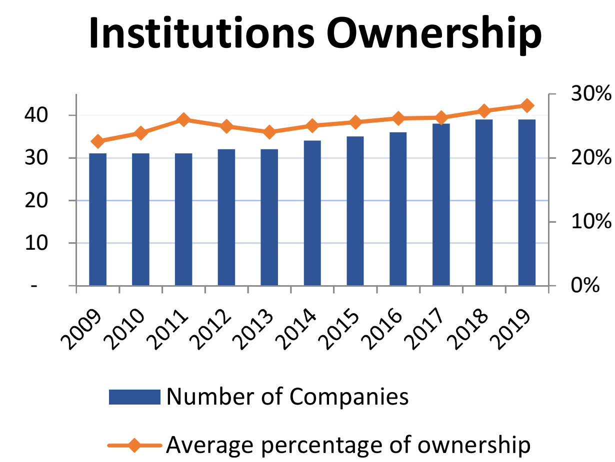
In the contrary to public and others, there has been an increase in alternative groups increasing their stakes in FTSE MIB companies. In 2009, individuals / Insiders[1], corporations, institutions, and government formed 0.87%, 29.16%, 22.58%, and 24.11% of the average ownership structure respectively. In 2019, the percentage increased to 2.11%, 30.87%, 28.20%, and dropped to 19.58% respectively.

The graph below represents the average ownership structure among companies in the FTSE MIB Index and how the structure has emerged over time.




## INSTITUTIONAL INVESTORS

Institutional shareholding ownership has been increasing at a slow pace over the years. In 2009, institutional shareholders invested in 31 companies and this had only increased to 39 companies by 2019. Moreover, the average holding in these companies by institutional shareholders has also been increasing. For the year 2009, the average institutional shareholders ownership was 22.58% and in 2019 it had risen to 28.20%, representing a 5.62% increase.



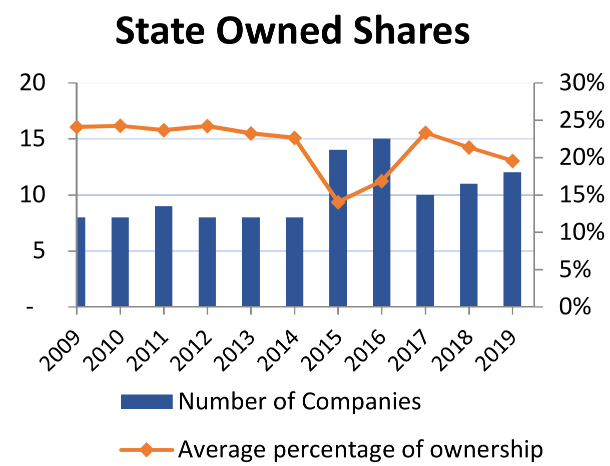

The positive part about the growing number of institutional investors is that direct engagement between shareholders and boards is likely to increase. This translates into better proposals being submitted by the Board during General Meetings. The presence of institutional shareholders also attracts the attention of proxy advisory firms, bringing corporate governance to the forefront of the Italian landscape.

## GOVERNMENT OWNERSHIP STRUCTURE

The Italian government has been trying to keep strategic companies under its control. In 2009, the Italian government owned shares in 8 companies within the FTSE MIB Index. The average percentage of its ownership was 24.11%. Six out of those eight companies operated in the Energy and Utility

[1] Individuals / Insiders ownership represents Officer and Director ownership as well as former directors or wealthy private individuals who do not have an investment vehicle.

industry, with the remaining two companies operating in the Financial industry.




Over the years, the government has diversified their ownership by investing in four additional companies within the FTSE MIB Index. However, the level of ownership has been lowered in these portfolio companies. In 2019, the average percentage of ownership of the government was 19.58%. The government's portfolio now spans across financial, automobile, electrical component, energy and utility related industries.

***The removal of governmental control and subsequent privatization has been proven in many cases and jurisdictions to maximize shareholders' value and increase returns for all stakeholders.***

The biggest investment that the government had in FTSE MIB Index was in Poste Italiane SpA. Poste Italiane SpA was a wholly state-owned company until early 2016, when the government decided to sell 35.3% of its stake to the public. It was the biggest privatization by the government since the late 1990s. Due to the huge public debt of the country, the Italian government has committed to sell its public assets. This in turn means more privatization is expected from the Italian government. Generally, the interface between good corporate governance and government-owned companies was a complicated mix.

## ACTIVIST INVESTOR

The concentrated ownership structure, a well-known characteristic of Italian companies, has given a less than favourable environment for activist investors in the past. Nevertheless, the trend of shareholder activism has been increasing in recent years and is projected to continue.

In 2009, 15 companies in the FTSE MIB index were owned by activist investors with an average ownership of 0.321%. The number was more than doubled in 2019; our analysis showed that 32 companies in the FTSE MIB Index were owned by activist investors with an average ownership of 0.98%. As can be seen from the below graph, shareholder activism started to rise in 2012.


After Europe's sovereign debt crisis got worse in 2012, a lot of parties demanded an improvement in the business sector, including improvement in corporate governance practices. Due to the crisis, the traditional company ownership in Italy has been weakened. This has been attracting activist investors to join the market. Activist investors find opportunities to gain profit by improving the performance of the company, which can often be achieved by improving the corporate governance of the company itself. In 2012, there were only 11 companies in the FTSE MIB, which were targeted by shareholder activism.

The number increased significantly to 24 companies by 2014.

In 2007, Britain based hedge fund Algebris Investments openly attacked Assicurazioni Generali the biggest Italian insurer and one of the largest in Europe. Algebris identified the governance structure of the company, in its opinion a key reason for its undervaluation by the market. Algebris ordered the company to decrease the executives' compensation; modify the governance structure, moving from two CEOs to a single Chief Executive as well as from one Executive Chairman to a Non-Executive one. The fund also asked the company to appoint Senior Managers with higher international experience. Finally, they identified that conflict of interests, existed between the major shareholder Mediobanca and Generali needed to be resolved. Since then, Italy has seen other public engagements between issuers and activists, including US fund Amber Capital (Amber) and Banca Popolare di Milano (BPM) in 2007, and Hermes Focus Asset Management Europe and Italmobilaire in 2008, Knight Vinke Asset Management and Eni in 2009.

Despite these cases, GAMCO Investors, Inc. and Royal London Asset Management Limited were the two main activist investors in the FTSE MIB Index. In 2007, GAMCO Investors, Inc. held shares in 10 companies and Royal London Asset Management Limited held shares in 4 companies with an average investment of 0.091% and 0.040% respectively. They increased their investment significantly. By 2016, GAMCO Investors, Inc. held shares in 14 companies and Royal London Asset Management Limited held shares in 28 companies with an average ownership of 0.253% and 0.015% respectively.

Telecom Italia is an example of a FTSE MIB company that has been a recent target of activism. Activist investor Vivendi acquired a stake in Telecom Italia in 2014. Since then, they have increased their grip on the company and had acquired 4 board seats in by 2015. In July 2017, Vivendi succeeded in putting down the CEO of Telecom Italia at that time, Flavio Cattaneo. Vivendi was unhappy with his performance and also with politically charged comments by Cattaneo that did not meet the company's standards. Vivendi then appointed their Chief Convergence Officer, Amos Genish, to sit as the CEO of Telecom Italia.

In 2018, American activist Elliott Management aimed to shake-up the board, by attempting to replace six of Vivendi-nominated members. Their rationale was that this would improve the company's strategy and governance. Vivendi directors were accused of serving their own self-interest and criticized for not adopting the best strategies for the company. Elliott's goal was to refresh the board with new members and appoint directors with relevant experience and expertise. Eventually, Elliott Management's list of directors, which included 10 independent Italian business figures, was chosen to lead at the board of TIM. Vivendi had proposed a list of directors primarily including its own employees and CEO. This list failed to satisfy or convince the members of the board of directors of Telecom Italia.

While markets generally react favorably to activist involvement, opponents of the movement usually raise concerns about the tilted interest of activist initiatives. The argument being that activists' investors may not wait to see through the promised changes, instead capitalizing on the the momentum of media exposure followed by positive reactions from the equity market. To this end, they choose to divest their shares before their proposed strategy is implemented. Perhaps the balance remains on shareholders to strive to maximize the positive impact of entry; better control of executive discretion while being ready to avert any value-destructive strategies. That notwithstanding, this new wave of silent revolution of shareholder activism across Europe's fourth-largest economy has been hailed as a step to move the country away from what has been termed as "a world of controlled capitalism".

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