# Chapter 5
# Corporate Governance in Italian Listed Companies

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**Abstract** In the past few decades a growing number of research studies have investigated the effect that insider ownership has on other corporate governance variables like the risk of expropriation for the minor shareholders, the demand for outside directors, etc. An increasing number of studies have analyzed the relationship between insider ownership and corporate performance in Anglo-Saxon countries, Continental Europe and emerging economies.

Regarding Italy, previous studies on corporate governance have highlighted that a listed company featured by concentrated ownership is likely to have a high incidence of insider shareholders representation on the board. This context might enhance an agency conflicts between large controlling shareholders and other stakeholders like minority shareholders and other outside investors. In this case the presence of an adequate number of non executive and independent directors as well as a functioning board's committees appear to be fundamental to counterbalancing the power exercised by owner-managers (or by managers-owner) and reduce the risks of private benefits exploitation. The recent changes in Italian normative requirements goes in this direction and recommend the introduction of mechanisms like the presence of independent directors, the CEO duality, the audit and remuneration committee that are not in line with the traditional corporate governance systems of Italian company but might reinforce the level of protection for outside stakeholders.

Basing on the aforementioned considerations, the researchers intend to analyze if and how Italian listed companies have changed their governance model to incorporate the new corporate governance rules. A specific focus regards the interaction of insider owners and outsider directors that seem to be a critical factor for the effectiveness of the corporate governance system in Italian context where lots of listed companies are controlled by a family/individual.

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The theoretical part of the research analyzes the institutional context in which Italian listed companies operate and how it has changed in the last decade and the main research streams that have investigated the interaction between the inside ownership and the outsider directors.

The empirical part of the research is based on the analysis of the data collected through an empirical survey of companies listed to Milan Stock Exchange. A total of 145 corporate governance reports (corresponding to about 60 % of the total non-financial listed companies) issued in the period 2006–2010 has been investigated.

Some features observed like ownership structure, insider ownership remained the same over the period analyzed while other variables like the percentage of outside shareholders (like hedge funds), the proportion of independent directors, the number of the audit committee meetings changed noticeable.

Overall, the results show that the increasing of monitoring mechanism (like a high proportion of independent directors) during the period observed could contribute to reduce the risk of insider opportunistic behaviour.

## 5.1 Introduction

In recent years, the academic community has been debating about the effectiveness of the monitoring role played by independent directors, especially in settings with concentrated ownership, where the agency conflict is between large controlling shareholders and minority shareholders (Gutierrez Urtiaga and Saez 2012). In this setting, featuring the majority of the countries in the world (Shleifer and Vishny 1997), there's a growing debate regarding whether the independent directors are the right pill to cure the problem of the minority expropriation. In such a context, large controlling shareholders can control the nomination process of directors, selecting independent directors under their influence in order to contain the intensity of board monitoring (Jensen 1993; Vafeas 1999; Shivdasani and Yermack 1999).

Dominant shareholders expressing board leadership (CEOs or executives) can also set the board's and the committees' agenda, influencing the decision control activity (Carcello et al. 2002; Laksmana 2008).

The situation depicted above is likely to make the monitoring action exercised by the independent directors trivial and inconsistent and to reduce the protection of the minority shareholders interests.

This paper focuses on Italian listed companies. Italy is featured by large controlling shareholders, often sitting in the board as CEOs or executives. Other hallmarks of the Italian context are the widespread perception of a lack of independence by outside directors and the weak legal protection for small investors (Di Pietra et al. 2008; Allegrini and Greco 2011). This type of context is subject to significant risks of wealth expropriation by dominant shareholders and that of scant minority investors' protection (Zingales 1994; Shleifer and Vishny 1997).

The Italian legislation allows minority shareholders to nominate a number of directors at the general shareholders meeting. If the minority shareholders propose a list of candidates, at least one, is to be mandatorily included in the board.

"Minority directors" are usually non-executives and have the requisites to be classified as independent.

In our research, we distinguish between independent directors nominated by the controlling shareholders and minority directors. We then investigate whether institutional investors' shareholding affects the presence of such types of directors. The research extends to whether the presence of minority directors affects the audit, remuneration and nomination committees presence and activity.

This article proceeds as follows: Sect. 5.2 provides a brief overview of the changes regarding Italian rules on corporate governance over the past 20 years. The analysis is focused on the requirements introduced to strengthen the protection of the minority shareholders and particularly on the percentage of the minority in the board. Section 5.3 discusses the literature and describes the hypotheses. Section 5.5 presents the empirical results. The conclusions are included in Sect. 5.6

## 5.2 The Institutional Background

This paragraph intends to provide a brief overview of Italian legal and institutional frameworks regarding the corporate governance system and how it has evolved over the past two decades. This analysis is mainly focused on the regulations introduced for reinforcing the protection of the minority shareholders and particularly on a new actor sitting on the board, "the minority director".

During the 1990s, many authors (Barca 1994; Bianchi and Enriques 2001) pointed out that Italian rule-makers needed to put the legal protection of the outside investors at the top of the reform's agenda. Zingales' analysis (1994), regarding the value of different types of stocks (voting vs. non-voting), showed that in Italian listed companies the market price of voting shares were approximately 90 % more than non-voting shares (*azioni di risparmio*), whilst in other countries this difference counted on average less than 20 %.

Zingales' conclusion was that this difference is mainly due to the weak legal protection for minor shareholders, who generally own non-voting shares against the risk of exploitation of the company's resources made by managers and controlling shareholders.

In a macro perspective, this lack of protection might reduce the ability of the listed company to raise outside funds and disincentive the investment of institutional investors. La Porta et al. (2000) believed that the low protection of outsider investors explains why the Italian stock market was so underdeveloped compared to other industrialized economies.

Other features affected the protection of outside investors in the Italian context. Traditionally the majority of Italian listed companies featured as a concentrated

ownership structure[1] controlled by a family, a coalition and in some cases by the State. The pyramidal groups are widespread and the hostile takeovers quite rare. These factors together with cross-ownership and interlocking directorates determined a limited contestability of the company's control and consequently reduced the effectiveness of the threats that the minor shareholders may exercise on block-holders.

In the family company, the largest shareholder often sits in the board as Chairman and/or CEO increasing the risk that the controlling shareholder may extract private benefits from the company by using a variety of methods (Anderson and Reeb 2004; Atanason et al. 2011).

Taking into account all of these circumstances, in this setting the principal-agent problem is not between the shareholders and the managers (Fama and Jensen 1983), but between the minority shareholders and the block-holders (Melis 2000).

Since the mid 1990s, a set of rules has been introduced in Italy to protect outsider investors and support the growth of the national stock market.[2] Before analyzing how the legal protection of the minority has changed, it is worthwhile to point out some peculiarities regarding the governance system of Italian companies in order to help readers to understand which mechanisms might reduce the minority expropriation problem in the Italian setting.

Since January 2004, listed companies could choose to adopt one of the following systems[3]: dualistic horizontal, an Italian-specific system, dualistic vertical, inspired by the Rhenish system[4]; monistic, inspired by the Anglo-Saxon system.[5]

A research carried out on Italian listed companies pinpoints that the dualistic horizontal system is much more widespread than the other two models (Assonime 2011), see Table 5.1. This Italian specific system is dualistic, given the existence of the board of directors acting as the managing body and the board of statutory auditors (called Collegio Sindacale) which is charged with a control responsibility, and is defined as "horizontal" because both of these bodies are appointed at the shareholders' meeting.

Focusing on the minority shareholders protection, one can distinguish the mechanisms of safeguarding in two groups: direct and indirect.

The *direct mechanisms* are those that can be executed directly by the shareholders such as the convocation of the shareholders' meetings or the exercise of voting rights. To strengthen the rights of the minority in listed companies, the

[1] A research carried out by Consob (1999) shows that largest shareholders own on average 60 % of the company shares. See for details Bianchi and Enriques (2001).

[2] The main legislative acts we refer to are the Draghi reform (1998), the reform of company law (2003), the so-called "Law of Saving" (2005) and the Legislative Decree n. 12/2010 for the enactment of the European Shareholder Rights Directive.

[3] Before the 1st January 2004, joint stock companies could only adopted the dualistic horizontal models so that today this model is called "traditional" model.

[4] The dualistic vertical model features by a supervisory board elected by the shareholders and a management board elected by the supervisory board.

[5] The monistic model is frequently named one-tier system due to the presence of a single body: the board of directors.

**Table 5.1** Governance models used in Italian listed companies

| | Frequency (%) |
|---|---|
| Dualistic horizontal model | 96.1 |
| Dualistic vertical model | 2.6 |
| Monistic model | 1.3 |

Source: Assonime 2011 (The empirical investigation of Assonime considers only Italian companies which are listed exclusively to the MSE for a total of 252 firms. Foreign companies listed to MSE (45) have been excluded from the analysis)

national legislators have defined a specific regulation for these firms. In respect to the non listed company, the Draghi reform has reduced the thresholds: (1) to ask for the convocation of the shareholders' meeting, from 20 % to 10 % of the equity issued[6]; (2) to bring a liability action against the directors for serious irregularities, from 10 % to 5 %; (3) to exercise other rights such as requiring an investigation into the board of statutory auditors.

Moreover, the direct mechanisms also include measures introduced by the European Shareholder Rights Directive (2007/36/EC) adopted in Italy in 2010. A detailed analysis of the contents of the Directive doesn't fall into the scope of this work. Suffice to say that this Directive intends to reinforce the minority shareholders activism through the possibility to use electronic means for exercising voting rights, and a greater transparency of the voting procedures at the shareholders' meetings (including proxy voting), etc.

The *indirect mechanisms* involve the representation of the minority shareholders on the board of directors and on the board of statutory auditors (called "Collegio Sindacale"). Regarding this issue, comparative studies of corporate governance regulations in different countries, notes that Italy shows some interesting peculiarities (Hopt 2001). Particularly, for Italian listed companies the representation of the minority shareholders on the above-mentioned bodies is mandatory. The law imposes that at least one member of the board of directors and also of the board of statutory auditors is elected by the monitory of shareholders.[7]

The election of these members is based on a list of candidates proposed only by the minority shareholders and the election procedure is regulated by each company by-law according to the criteria defined by the Consob.

The law does not require that the minority directors should be non-executive or independent even though it's likely that these board's members are not involved in managing the organization.

It is worth highlighting that all these requirements define only the minimum thresholds to which firms must comply. To strengthen the protection of the minority shareholders, in their company, by-law each firm can voluntarily state to have a

[6] The law recognizes the possibility to listed companied to define a threshold lower than 5 % of common share could be introduced by the company-by-law.

[7] Furthermore regarding the board of statutory auditors the law imposes that the Chairman must be chosen among the members elected by the minority shareholders.

higher number of minority directors and/or require the participation of such a director to be a member of the board's committees (Bianchi et al. 2011).

The independent directors could also be seen as an indirect mechanism to protect the minority in the presence of a block-holder. Bebchuk and Hamdani (2009) assert that independent directors can protect the minority shareholders if they oriented their monitoring activities to the controlling shareholders rather than the CEO. However Gutierrez Urtiaga and Saez (2012) are quite skeptical about the possibility that independent directors elected by the controlling shareholders can reduce the risk of a minority expropriation because the possibility that they conform to the interests of whoever elected them is quite high.

Based on these circumstances, it is interesting to empirically analyze the composition of the board of the companies listed on the MSE (Milan Stock Exchange) in order to evaluate:

- To which extent independent directors appointed by controlling shareholders and minority directors sit on the company's board;
- Whether the ownership composition is associated with the presence and the number of the independent and minority directors;
- Whether the distinction between independent and minority directors influences the activism of the board's committees.

## 5.3 Literature Review and Research Hypotheses

In the agency theory perspective, the independent directors are often seen as an internal control mechanism, aimed at reducing the potential conflicts of interest between the management and shareholders. This view is reflected in many corporate governance codes and listing rules, which consider the independent directors as an important line of defense of shareholders against the power of managers, Academic literature, studying especially the Anglo-Saxon countries, extensively studied the contribution of the independent directors in the mitigation of agency conflicts. Empirical research found mixed evidence about possible benefits to shareholders related to a higher proportion of independent directors in the board, such as increased voluntary disclosure (Eng and Mak 2003; Cheng and Courtenay 2006; Lim et al. 2007), constrained earnings manipulation (Bradbury et al. 2006; Park and Shin 2004; Peasnell et al. 2005; Cornett et al. 2008), and reduced frequency of financial frauds (Carcello et al. 2002) The differences may depend on the context studied and on the effective role played by independent directors.

The effectiveness of the monitoring function exercised by independent directors depends upon many factors, for instance the "real degree" of independency, as well as the knowledge of the company's operations, the professional background, etc.

A relevant issue for independency regards the nomination process of directors and who appoints the independent directors. Where independent directors are appointed by the same (controlling) shareholders who appointed the CEO and other executive directors, the independency might be hindered and the protection of the minority shareholders reduced. A stream of corporate governance literature

has empirically analyzed the relationship between ownership structures and the presence of independent directors in the board. Several empirical studies found that ownership concentration is negatively associated with the presence of independent directors (Li 1994). Also, institutional investors' ownership was found to be positively associated with board composition. A higher institutional investors' shareholding was found to be positively related to board composition in U.S., U.K. and French firms (Bathala and Rao 1995; Gillan and Starks 2000; O'Sullivan 2000; Chouchene 2010). These studies also found that the institutional investors are more active than the individual investors and that they participate more frequently in the directors' nomination process.

It is therefore interesting to analyze if similar results may be found in Italian listed firms. For this purpose, we split the directors labeled as independent into two categories: independent directors appointed by the controlling shareholders and those appointed by the minority shareholders. We test if the presence of institutional investors may favor a higher percentage in both cases. Consistently with prior research, we hypothesize that the participation of institutional investors has a positive impact on the presence of independent and minority directors. We formulate the following hypotheses.

H1: *Institutional ownership is positively associated with the proportion of independent directors nominated by controlling shareholders in the board*

and

H2: *Institutional ownership is positively associated with the proportion of minority directors in the board*

The representation of shareholders in the board can affect the composition and the functioning of the board's committees, as well as the functioning of the board itself. Since 1999, the Italian corporate governance code has recommended to listed companies the creation of three committees: the audit, the remuneration and the nomination committee, each with a majority of independent directors. These committees are traditionally seen as important mechanisms for reducing the various conflicts between managers and shareholders and to foster the independency-in-fact, giving to the independent directors the possibility of acting both jointly and autonomously together with a high level autonomy from the CEO (Gordon 2003).

The effectiveness of these committees in fulfilling their responsibilities depends on different features. If we consider the studies regarding the audit committee (DeZoort and Salterio 2001; Abbott et al. 2004), authors use as indicators for measuring the quality of the monitoring action on the financial reporting process, the financial expertise and auditing knowledge of the committee members. Undoubtedly, the expertise of independent directors represents a critical issue for the effectiveness of the monitoring function but no less important is the nominating process of independent directors.

In companies which dispersed ownership, authors (Lorsh and MacIver 1989) highlight the risk stating that when the CEO controls the selection process of the board's members the independent directors may assume passive and ineffectual behavior.

If we consider the companies with a concentrated ownership structure, this problem is more likely to appear when independent directors are elected by the same owner that elects the CEO rather than from the minority of shareholders. In this case, independent directors could tend to conform to the interests of the shareholders who appointed them, serving as "stewards" and/or providing a mild monitoring activity.

Considering the distinction of the independent directors between those elected by the controlling shareholders and those elected the minority, it is interesting to analyze whether the percentage of minority directors is associated with the presence of the board's committees and on the level of activity of these committees, measured by the number of meetings held. Thus we posit the following hypotheses:

H3: *The proportion of minority directors in the board is positively associated with the presence of the audit, remuneration and nomination committees;*

H4: *The proportion of minority directors in the board is positively associated with of the audit, remuneration and nomination committees meeting frequency.*

## 5.4 Research Methodology

### *5.4.1 Sample Selection*

Our initial sample includes all non-financial companies listed on the Italian Stock Exchange.[8] We discarded the companies: (1) with a dualistic vertical governance structure; (2) included among the Micro-Cap segment of MSE (that is very small listed companies); (3) not listed continuously from the year 2006 to 2010.

Our final sample is composed of 145 companies (corresponding to about the 60 % of the population of non-financial listed companies). For each company we gathered the corporate governance data needed from reports downloaded from the Italian Stock Exchange website. We collected the 2010 governance data.[9]

### *5.4.2 Variable Definitions*

To test the hypotheses, the dependent variables used in this study are defined as follows. The percentage of minority directors in the board is measured by their number on the total amount of directors (MINORIND). We also used the proportion of independent directors nominated by controlling shareholders over the total

[8] We did not consider financial, banking and insurance companies, because of different governance requirements and specific monitoring activity delivered by Authorities (i.e. Bankitalia, ISVAP).

[9] As mentioned below, we also collected the 2009 data to perform a robustness check.

number of directors (MAJORIND).[10] We used three dummy variables for the presence of the board's committee: audit (AC), remuneration (REM) and nomination (NOM). Consistently with prior research (Menon and Williams 1994; Sharma et al. 2009; Greco 2011), we proxied the directors' activity with the number of meetings held in the year 2010 for the audit committee (ACMEET), the remuneration committee (REM) and the nomination committee (NOM).

The independent variables used in this study are defined as follows Ownership concentration (OWN) which is measured by the proportion of ordinary shares held by the first owner (Parbonetti and Cerbioni 2007; Allegrini and Greco 2011). Institutional ownership (INST), which is measured using the proportion of ordinary shares held by institutional investors compared with those held by others (Koh 2003; Greco 2011).

We also included in our model three other control variables. The presence of CEO duality (CEOCH) is measured by a dummy variable coded 1 if the CEO is also the Chairman of the board, 0 otherwise. The executive directors' weight in the board is measured by their number on the total number of directors in the board (EXE). We also controlled in our models for the total number of directors in the board (BSIZE) (Table 5.2).

## 5.5 Empirical Analysis

### 5.5.1 *Descriptive Statistics*

Tables 5.3 and 5.4 report the descriptive statistics. We found 81 minority directors in the sample companies representing 5 % of the total directors (1463).

Forty six companies out of 145 had at least one minority director about the 31 % of the sample. This result shows the absence of a minority director for a majority of the companies analyzed, which means that the minority shareholders have not presented a list of candidates. Based on this evidence, it will be interesting to analyze in detail whether the presence of institutional investors as minority directors is associated with the presentation of the list of directors.

All the minority directors found were independent, with just one exception of non-executive not independent.

Independent directors nominated by controlling shareholders are present in all the sample companies (with just one exception), and they are on average 35 % of the total directors in the board.

Ownership concentration is high, being on average 45 % of the total ordinary shares (Table 5.3). This is consistent with the feature of the Italian capital market, with most companies controlled by families or a single shareholder owning often more than 50 % of the ordinary shares.

[10] These directors were nominated in the so-called "majority list", the list of presented by the controlling shareholders.

**Table 5.2** Definition and measurement of variables

| Variable | Definition | Measurement | Data source |
|---|---|---|---|
| MINORIND | Directors nominated by minority shareholders | Proportion of directors nominated by minority shareholders over the total number of directors | Corporate governance report |
| MAJORIND | Independent directors nominated by controlling shareholders | Proportion of independent directors nominated by controlling shareholders over the total number of directors | Corporate governance report |
| AC | Presence of an audit committee | Dummy variable, 1 if the committee is present, 0 otherwise | Corporate governance report |
| REM | Presence of a remuneration committee | Dummy variable, 1 if the committee is present, 0 otherwise | Corporate governance report |
| NOM | Presence of a nomination committee | Dummy variable, 1 if the committee is present, 0 otherwise | Corporate governance report |
| ACMEET | Audit committee meeting frequency | Number of meetings held in the fiscal year 2010 | Corporate governance report |
| RMEET | Remuneration committee meeting frequency | Number of meetings held in the fiscal year 2010 | Corporate governance report |
| NMEET | Nomination committee meeting frequency | Number of meetings held in the fiscal year 2010 | Corporate governance report |
| OWN | Ownership concentration | Proportion of ordinary shares held by the first owner | Consob |
| INST | Institutional investors ownership | Proportion of ordinary shares held by institutional investors | Consob/Corporate governance report |
| CEOCH | CEO duality | Dummy variable (1 if the CEO is also the Chairman of the board, 0 otherwise) | Corporate governance report |
| EXE | Executives | Percentage of executives directors in the board | Corporate governance report |
| BSIZE | Board size | Total number of directors in the board | Corporate governance report |

Institutional investors are present in 54 % of the sample companies. In all these cases the institutional investors are minority shareholders. Their average weight is 4 % of the ordinary shares (median 2 %, see Table 5.3). CEO duality is widespread with about one third of the company[11] having the CEO serving also as Chairman of the board.

[11] Allegrini and Greco (2011) provide an international comparison among the board of directors featured in Italy, Spain, UK, Australia and US.

**Table 5.3** Descriptive statistics for board features and ownership structure ($n = 145$)

| Continuous and count variables | Mean | Standard deviation | 1st quartile | Median | 3rd quartile |
|---|---|---|---|---|---|
| MINORIND | 0.05 | 0.94 | 0.00 | 0.00 | 0.10 |
| MAJORIND | 0.35 | 0.16 | 0.25 | 0.33 | 0.43 |
| EXE | 0.29 | 0.15 | 0.15 | 0.28 | 0.40 |
| BSIZE | 10.09 | 3.32 | 7.00 | 9.00 | 12.00 |
| OWN | 0.45 | 0.19 | 0.30 | 0.50 | 0.59 |
| INST | 0.04 | 0.05 | 0.00 | 0.02 | 0.07 |
| Dichotomous variables (1,0) | Yes% (1) | No% (0) | | | |
| CEOCH | 32.6 % | 67.4 % | | | |

Variables definition: *MINORIND* proportion of minority directors on the total number of directors, *MAJORIND* proportion of independent directors nominated by controlling shareholders on the total number of directors, *OWN* ownership concentration, percentage of ordinary shares of the first owner, *INST* institutional investors shareholding, percentage of ordinary shares owned by institutional investors, *CEOCH* dummy variable, 1 if the CEO is also the Chairman of the Board, 0 otherwise, *EXE* percentage of executives directors in the board, *BSIZE* board size, total number of directors in the board

**Table 5.4** Descriptive statistics for the audit, remuneration and nomination committee ($n = 145$)

| Continuous and count variables | Mean | Standard deviation | 1st quartile | Median | 3rd quartile |
|---|---|---|---|---|---|
| ACMEET | 5.84 | 3.61 | 4.00 | 5.00 | 7.00 |
| RMEET | 2.66 | 2.01 | 1.00 | 2.00 | 3.00 |
| NMEET | 2.87 | 2.01 | 1.00 | 2.50 | 5.00 |
| Dichotomous variables (1,0) | Yes% (1) | No% (0) | | | |
| AC | 93.1 % | 6.9 % | | | |
| REM | 88.9 % | 11.1 % | | | |
| NOM | 11 % | 89 % | | | |

Variables definition: *AC* dummy, 1 if there is an audit committee, 0 otherwise, *REM* dummy, 1 if there is an remuneration committee, 0 otherwise, *NOM* dummy, 1 if there is a nomination committee, 0 otherwise, *ACMEET* audit committee meeting frequency, number of meetings of the audit committee in the year 2010, *RMEET* remuneration committee meeting frequency, number of meetings of the remuneration committee in the year 2010, *NMEET* nomination committee meeting frequency, number of meetings of the remuneration committee in the year 2010

Regarding the board's committee, the audit and remuneration committees are much more widespread than the nomination committee which exists in one company out of ten (Table 5.4). Several companies explain in the Governance Report that they do not create a nomination committee, being granted to the minority shareholders the possibility to appoint at least one director, by presenting a list at the general shareholder meeting.

### 5.5.2 Correlation Analysis

Table 5.5 reports the results of the Pearson correlation analysis. The proportion of minority directors in the board (MINORIND) is positively related to institutional investors ownership (INV), with $p$-value $<0.05$. The minority directors percentage on the board is not significantly associated with the presence of committees, but is positively and significantly associated with the activity of the audit committee (ACMEET, correlation significant at the 1 % level), the remuneration committee (RMEET, correlation significant at the 5 % level) and the nomination committee (NMEET, correlation significant at the 1 % level).

Also, the proportion of minority directors is negatively related to ownership concentration (OWN), with *p-value* $<0.01$, and is lower in companies with CEO Duality (CEO, negative correlation significant at the 1 % level) and higher proportion of executives in the board (EXE, negative correlation at the 5 % level).

The proportion of independent directors nominated by the controlling shareholders in the board (MAJORIND) is not significantly associated with the institutional investors shareholding and is positively associated with ownership concentration (*p-value* $<0.05$). Interestingly, the independent directors' proportion in the board is associated neither to the presence nor to the activity of the committees.

Overall, the results suggest that in firms with highly concentrated ownership, strong board leadership and a higher presence of executives, it is less likely to find minority directors. Active and organized shareholders (the type of shareholders usually nominating minority directors) probably prefer companies with more dispersed ownership along with a more open governance structure. The results may also suggest that minority directors are more active in the committees than the independent directors nominated by the controlling shareholders. Although formally belonging to the same category (they are all classified as independent), the shareholders nominating them appear to be influencing their behaviour. According to our results, the independent directors do not appear to be a homogeneous group with the same behaviour.

### 5.5.3 Multivariate Analysis

To test our hypotheses, we estimated the following Models. Models 1, 2 and 4 were estimated with OLS regressions. Model 3 with a Probit regression estimated for each committee: audit, remuneration, nomination. Model 4 was estimated only for the firms having an audit committee (134) and for those having a remuneration committee (126). The limited number of firms with a nomination committee (16) made the multivariate analysis inapplicable.

**Table 5.5** Pearson correlation analysis

| | MINORIND | MAJORIND | AC | REM | NOM | ACMEET | RMEET | NMEET | OWN | INST | CEOCH | EXE | BSIZE |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| MINORIND | 1 | −0.154* | 0.074 | 0.027 | 0.011 | 0.286*** | 0.206** | 0.490*** | −0.236*** | 0.204** | −0.207*** | −0.179** | 0.015 |
| MAJORIND | | 1 | 0.094 | 0.079 | 0.031 | 0.148* | 0.094 | −0.013 | 0.176** | 0.114 | −0.056 | −0.105 | 0.654*** |
| AC | | | 1 | 0.730*** | 0.091 | 0.000 | 0.000 | 0.000 | 0.104 | 0.200** | −0.007 | −0.000 | 0.283*** |
| REM | | | | 1 | 0.124 | −0.140 | 0.000 | 0.000 | 0.073 | 0.224*** | 0.008 | −0.048 | 0.301*** |
| NOM | | | | | 1 | 0.131 | 0.229*** | 0.000 | −0.101 | 0.151** | −0.055 | −0.014 | 0.003 |
| ACMEET | | | | | | 1 | 0.504*** | 0.595*** | −0.023 | 0.066 | −0.262*** | −0.131 | 0.151* |
| RMEET | | | | | | | 1 | 0.829*** | −0.086 | 0.126 | −0.311*** | −0.192** | 0.158* |
| NMEET | | | | | | | | 1 | −0.218 | 0.320 | 0.578** | −0.092 | 0.326 |
| OWN | | | | | | | | | 1 | −0.153* | −0.036 | 0.113 | 0.036 |
| INST | | | | | | | | | | 1 | −0.162* | 0.031 | 0.244*** |
| CEOCH | | | | | | | | | | | 1 | 0.169** | −0.321*** |
| EXE | | | | | | | | | | | | 1 | −0.306*** |
| BSIZE | | | | | | | | | | | | | 1 |

All $p$-values are two-tailed

***Coefficient is significant at the 0.01 level (two-tailed)

**Coefficient is significant at the 0.05 level (two-tailed)

*Coefficient is significant at the 0.10 level (two-tailed)

Variables definition: *MINORIND* proportion of minority directors on the total number of directors, *MAJORIND* proportion of independent directors nominated by controlling shareholders on the total number of directors, *AC* dummy, 1 if there is an audit committee, 0 otherwise, *REM* dummy, 1 if there is an remuneration committee, 0 otherwise, *NOM* dummy, 1 if there is a nomination committee, 0 otherwise, *ACMEET* audit committee meeting frequency, number of meetings of the audit committee in the year 2010, *RMEET* remuneration committee meeting frequency, number of meetings of the remuneration committee in the year 2010, *NMEET* nomination committee meeting frequency, number of meetings of the remuneration committee in the year 2010, *OWN* ownership concentration, percentage of ordinary shares of the first owner, *INST* institutional investors shareholding, percentage of ordinary shares owned by institutional investors, *CEOCH* dummy variable, 1 if the CEO is also the Chairman of the Board, 0 otherwise, *EXE* percentage of executives directors in the board, *BSIZE* board size, total number of directors in the board

Model 1

$$\text{MINORIND}^i = \beta_0 + \beta_1\text{OWN}_i + \beta_2\text{INST}_i + \beta_3\text{CEOCH}_i + \beta_4\text{EXE}_i + \beta_5\text{BSIZE}_i + \varepsilon_i$$

Model 2

$$\text{MAJORIND}^i = \beta_0 + \beta_1\text{OWN}_i + \beta_2\text{INST}_i + \beta_3\text{CEOCH}_i + \beta_4\text{EXE}_i + \beta_5\text{BSIZE}_i + \varepsilon_i$$

Model 3

$$\text{Presence of the committee}_i = \beta_0 + \beta_1\text{OWN}_i + \beta_2\text{INST}_i + \beta_3\text{CEOCH}_i + \beta_4\text{EXE}_i + \beta_5\text{BSIZE}_i + \beta_6\text{MINORIND}_i + \varepsilon_i$$

Model 4

$$\text{Committes meeting frequency}_i = \beta_0 + \beta_1\text{OWN}_i + \beta_2\text{INST}_i + \beta_3\text{CEOCH}_i + \beta_4\text{EXE}_i + \beta_5\text{BSIZE}_i + \beta_6\text{MINORIND}_i + \varepsilon_i$$

Variables definition: MINORIND = proportion of minority directors on the total number of directors; MAJORIND = proportion of independent directors nominated by controlling shareholders on the total number of directors; OWN = ownership concentration, percentage of ordinary shares of the first owner; INST = institutional investors shareholding, percentage of ordinary shares owned by institutional investors; CEOCH = dummy variable, 1 if the CEO is also the Chairman of the Board, 0 otherwise; EXE = percentage of executives directors in the board; BSIZE = board size, total number of directors in the board.

For Model 1 we detected heteroskedasticity with the White's (1980) test. We re-ran the regression with the White's (1980) heteroskedasticity-consistent standard errors and covariance and obtained the same results. This procedure shows that heteroskedasticity does not significantly affect our results (Wallace and Silver 1988; Greene 2003). We did not detect heteroskedasticity in the other models.

The variance inflation factor (VIF) score was calculated for each independent variable, in order to evaluate whether multicollinearity may be a cause of concern. VIF scores higher than 10 are likely to cause a multicollinearity problem (Gujarati 2004, p. 366). The highest VIF obtained across the models is slightly above 1.

Table 5.6 displays the results of the regression of Model 1 and Model 2. The proportion of minority directors (MINORIND) has a significant positive association with the institutional investors ownership (*p-value* $<0.05$). This result provides support for HP1. Institutional investors are qualified and professional shareholders actively participate in the directors' nomination process. The higher the investors stake is the more significant the presence of minority directors is on the board. This

**Table 5.6** Multivariate analysis Model 1 and 2

| | OLS Dependent variable: Independent directors nominated by minority shareholders (MINORIND) $n = 145$ | | OLS Dependent variable: Independent directors nominated by controlling shareholders (MAJORIND) $n = 145$ | |
|---|---|---|---|---|
| | Coeff. | *t*-statistic | Coeff. | *t*-statistic |
| Const | 0.166*** | 4.43 | 0.329*** | 4.88 |
| OWN | −0.093** | −2.59 | 0.119 | 1.56 |
| INST | **0.317**** | **2.03** | −0.074 | −0.23 |
| CEOCH | −0.038** | −2.43 | −0.005 | −0.18 |
| EXE | −0.107** | −1.99 | −0.155* | −1.83 |
| BSIZE | −0.003 | −1.53 | 0.002 | 0.49 |
| | Adj $R^2$ | 0.12 | 0.01 | |
| | F-statistics | 4.84 | 1.62 | |
| | *p*-value for F test | <0.00 | >0.10 | |
| | Max VIF | 1.28 | 1.28 | |

All *p*-values are two-tailed
***Coefficient is significant at the 0.01 level (two-tailed)
**Coefficient is significant at the 0.05 level (two-tailed)
*Coefficient is significant at the 0.10 level (two-tailed)
Variables definition: *MINORIND* proportion of minority directors on the total number of directors, *OWN* ownership concentration, percentage of ordinary shares of the first owner, *INST* institutional investors shareholding, percentage of ordinary shares owned by institutional investors, *CEOCH* dummy variable, 1 if the CEO is also the Chairman of the Board, 0 otherwise, *EXE* percentage of executives directors in the board, *BSIZE* board size, total number of directors in the board

is consistent with the need for minority investors to monitor the firm's management and mitigate the agency conflicts along with the information asymmetry.

The minority directors' percentage is negatively associated with ownership concentration (OWN), strong board leadership (CEO Duality, CEOCH) and executives' percentage in the board (EXE), in all the cases with the coefficients are significant at the 5 % level. This could suggest that companies with more dispersed ownership and with more open governance structure are selected by active and organized shareholders to propose candidates to directorship.

The proportion of independent directors nominated by controlling shareholders is not significantly associated with institutional investors' ownership (Table 5.5). There is therefore no support for HP1. This result marks a significant difference with studies on the US and the UK settings (Bathala and Rao 1995; Gillan and Starks 2000; O'Sullivan 2000). Controlling shareholders may appoint independent directors for stewardship purposes and/or to ensure mild decision control activity. For this reason, minority investors clearly prefer their own monitors in the board.

The Probit regressions of Model 3 with the presence of the committees as dependent variables fail to provide support for HP3 (not reported). The proportion of minority directors in the board has no impact on the decision to set up the audit, the remuneration and the nomination committee. The regression analysis results are in line with the results of the correlation analysis (see above).

**Table 5.7** Multivariate analysis Model 4

| | Panel A | | Panel B | |
|---|---|---|---|---|
| | Dependent variable: Audit committee meeting frequency (ACMEET) $n = 134$ | | Dependent variable: remuneration committee meeting frequency (RMEET) $n = 126$ | |
| | Coeff. | *t*-statistic | Coeff. | *t*-statistic |
| Const | 4.286** | 2.50 | 3.2455*** | 3.25 |
| OWN | 0.857 | 0.51 | −0.465 | −0.49 |
| INST | −1.593 | −0.27 | 2.164 | 0.63 |
| CEOCH | −1.341* | −1.89 | −1.075*** | −2.67 |
| EXE | −0.515 | −0.23 | −1.486 | −1.18 |
| BSIZE | 0.113 | 1.08 | 0.0170 | 0.28 |
| MINORIND | **10.069*** ** | 2.97 | 2.370 | 1.24 |
| Adj $R^2$ | 0.14 | | 0.10 | |
| F-statistics | 3.40 | | 3.19 | |
| *p*-value for F test | <0.00 | | <0.00 | |
| Max VIF | 1.16 | | 1.16 | |

All *p*-values are two-tailed
***Coefficient is significant at the 0.01 level (two-tailed)
**Coefficient is significant at the 0.05 level (two-tailed)
*Coefficient is significant at the 0.10 level (two-tailed)
Variables definition: *MINORIND* proportion of minority directors on the total number of directors, *ACMEET* audit committee meeting frequency, number of meetings of the audit committee in the year 2010, *RMEET* remuneration committee meeting frequency, number of meetings of the remuneration committee in the year 2010, *OWN* ownership concentration, percentage of ordinary shares of the first owner, *INST* institutional investors shareholding, percentage of ordinary shares owned by institutional investors, *CEOCH* dummy variable, 1 if the CEO is also the Chairman of the Board, 0 otherwise, *EXE* percentage of executives directors in the board, *BSIZE* board size, total number of directors in the board

Table 5.7 shows the regression of Model 4 with the audit committee and the remuneration committees meeting frequencies. The minority directors' percentage in the board is positively associated to the audit committee meeting frequency, with a high level of significance (Panel A, coefficient significant at the 1 % level) and has no significant association with the remuneration committee meeting frequency (Panel B). The lack of significant association with the remuneration committee activity might depend on the poor variability of the number of remuneration committees meeting frequency across companies (see descriptive statistics in Table 5.4). This committee usually meets twice a year. Thus, in this case the proxy could not capture the differences in the activity of the directors.

Overall, the results support HP4 in regard to the audit committee. The minority directors are engaged to play an active monitoring role, especially in relation to financial external reporting and the transactions with related parties. Minority shareholders have significant incentives to foster the audit committee activity, since an intensive monitoring environment can limit the information asymmetry and the risk of private benefits extraction by controlling shareholders (Leftwich et al. 1981; Shleifer and Vishny 1997; Dyck and Zingales 2004).

### *5.5.4 Further Investigations*

We repeated the regressions of Model 3 and 4 using the proportion of independent directors in the board instead of that of the minority investors. The results show that the independent directors' percentage has no significant association with either the audit committee or the remuneration committee meeting frequencies. We added this variable to our models obtaining consistent results.

We also re-ran our model to include other control variables, such as the size of the firm and the profitability, obtaining consistent results. Finally, we re-ran our models using the 2009 governance data, also obtaining consistent results.

## 5.6 Conclusions

In this paper, we investigated whether the presence of minority directors and that of independent directors nominated by the controlling shareholders is influenced by institutional investor ownership. We also investigated the impact of the minority directors percentage on the board based on the presence and activity of the audit, remuneration and nomination committees.

Our results show that increased institutional investors shareholding is associated with a higher proportion of minority directors in the board however it is not associated with the proportion of independent directors.

The findings show that an active and organized minority shareholder is fundamental for ensuring the presence of the minority directors who become a key element in reducing the risk of minority expropriation.

When the minority shareholders are inactive, and do not present a list of candidates, they tend to rely on the monitoring action exercised by the independent directors. The results show that the percentage of independent directors increases in the presence of a higher concentrated ownership.

Combining these evidences, it seems that there might exist, a sort of tacit agreement between the inactive minority shareholders and the controlling owners, in addition the controlling shareholders appoint a higher number of independent directors in order to provide a high level of assurance to the minority, who relinquish presenting a list of their candidates.

However in this setting the presence of a high proportion of independents may provide only the appearance of a more effective monitoring action.

This study shows that the minority directors percentage in the board is associated to an increased activity of the audit committee, whilst in the case of the independent directors appointed by the majority of shareholders the association is weaker. An implication of this finding could be that controlling shareholders appoint independent directors as stewards and/or to ensure mild decision control activity.

Generally speaking, in a setting featured by large controlling shareholders, an active audit committee may serve as an effective device in reducing the information asymmetry and risks of wealth expropriation by dominant owners.

The study acknowledges some limitations. Firstly, the meeting frequency is an imperfect proxy for the monitoring activity delivered, since we have no idea of how the meeting time is spent. The presence of minority directors could improve the monitoring "quality" (i.e., the time spent in effective decision control), by providing more attentive and dutiful work. However, in regard to this limitation, it should be acknowledged that useful decision control is unlikely to occur if the committees meetings take place only once per year or no meetings are held at all (Fernandez Mendez and Arrondo Garcia 2007). Secondly, we studied the 2010 data and the 2009 data in order to check the robustness of the results. However, since governance structures do not usually change in the short term, future research could investigate how the impact of the presence of minority directors changes over time. Future research could also focus on international comparisons.

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