



REVOLUTION IN ITALIAN COMPANIES OWNERSHIP STRUCTURE

The weakening of traditional company owners

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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-third of listed companies in Italy is controlled by a single shareholder.

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 this loyalty shares is to encourage long-term shareholders and prevent short-termism. France has had similar loyalty shares 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

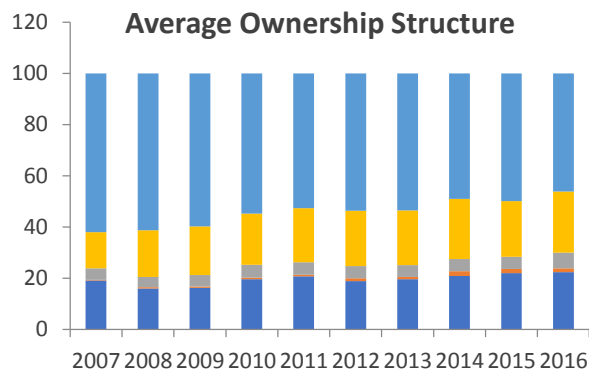
Research performed by DirectorInsight shows a vast reform in the FTSE MIB, Italy's largest companies', ownership structure over the last 10 years. In 2007, 62.05% of the average ownership structure was held by public and others (including families). The percentage shares owned by them were decreasing at a steady pace over the period. In 2016, public and others held averagely 46.13% of companies across the FTSE MIB representing 16.37% decrease.





In the contrary to public and others, the other types of ownership have been increasing their stake in FTSE MIB companies. In 2007, individuals / Insiders¹, corporations, institutions, and government formed 0.28%, 14.10%, 19.12%, and 4.45% of the average ownership structure respectively. In 2016, the percentage increased to 1.49%, 23.87%, 22.35%, and 6.15% respectively.

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

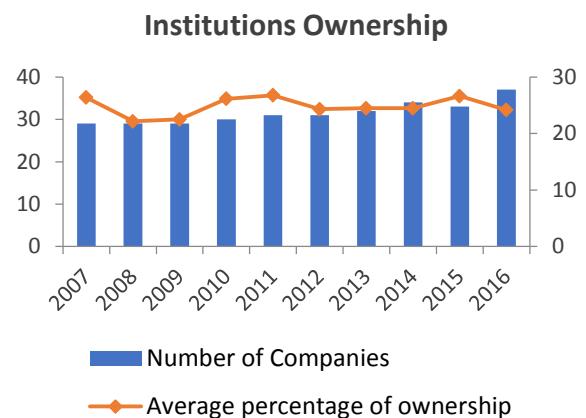


■ Institutions ■ Individuals/Insiders
 ■ State Owned Shares ■ Corporations
 ■ Public and Other

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.

INSTITUTIONAL INVESTORS

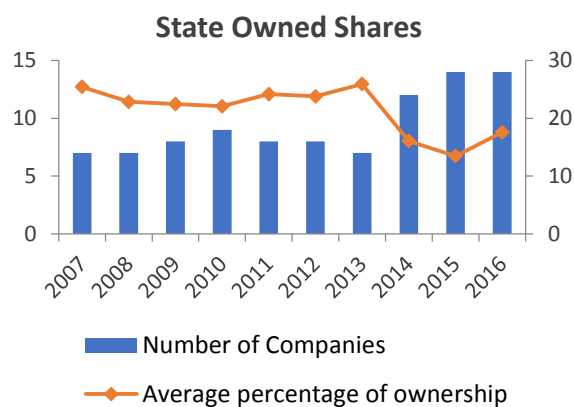
Institutional shareholding ownership has been increasing at a low pace all over the years. In 2007, institutional shareholders invested in 29 companies and increased to 37 companies in 2016. However, the average holding in these companies of institutional shareholders has slightly been decreasing. For the year 2007, the average institutional shareholders ownership was 26.37% and 24.17% in 2016, representing a 2.2% decrease.



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

GOVERNMENT OWNERSHIP STRUCTURE

The Italian government has been trying to keep strategic companies under its control. In 2007, the Italian government owned shares in 7 companies within the FTSE MIB Index. The average percentage of its ownership was 25.42%. 6 out of those 7 companies operated in the Energy and Utility industry, with the remaining one company operating in the Financial industry.



Over the years, the government has diversified their ownership by investing in additional 7 companies within the FTSE MIB Index. However, the level of ownership has been lowered in these portfolio companies. In 2016, the average percentage of ownership of the government was 17.57%. The government's portfolio now spans across agricultural, 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, 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. Thus, more privatization could be expected from the Italian government. Generally, the interface between good corporate governance and government-owned companies could be a complicated mix.

ACTIVIST INVESTOR

Concentrated ownership structure, which is 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 2007, 14 companies in the FTSE MIB index were owned by activist investors with an average ownership of 0.128%. The number was more than doubled in 2016; our analysis showed that 30 companies in the FTSE MIB Index were owned by activist investors with an average ownership of 0.777%. 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 be achieved by improving the corporate governance of the company itself. In 2012, there were only 12 companies in the FTSE MIB, which were targeted by shareholder activism.

The number significantly increased to 23 companies in 2013.

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. In 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 been increasing their grip on the company and acquired 4 board seats in Telecom Italia in 2015. In July 2017, Vivendi succeeded to put down the CEO of Telecom Italia at that time, Flavio Cattaneo. Vivendi was unhappy with Cattaneo's performance and also politically charged comments by Cattaneo that did not meet the company's standards. Vivendi then assigned their Chief Convergence Officer, Amos Genish, to sit as the CEO of Telecom Italia. 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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