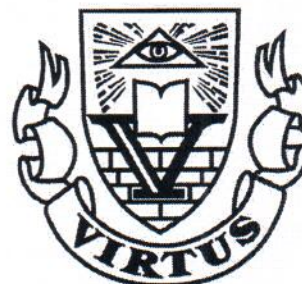


CORPORATE OWNERSHIP & CONTROL

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THE ITALIAN TWO-TIERS MODEL. EVIDENCE AND COMPARISON WITH SOME OTHER COUNTRIES

Roberta Provasi*, Patrizia Riva**

Abstract

New dynamics and globalized economy has led to the need to modify the Corporate Governance systems. Many countries have not identified a unique model for the company management but they allow free choice between continuing to use the traditional models adopted by the country itself or implementing different models sometimes considered more suitable with the aims and operational management of the companies. The new Corporate Governance model introduced in the most global jurisdictions is the two-tiers model (or dual model) considered the most suitable to achieve a better separation between ownership and control and to ensure a better transparency. The introduction of the two-tier system of Corporate Governance is not without uncertainty; it has affected all countries except the Anglo-Saxon ones. The purpose of this research is to investigate the features of the dualistic governance model in some countries different for their culture and legislative system. In particular the research aims to point out the characteristics of the dual model introduced for the first time in the Italian Legal System by Law No. 6/2003 and to perform a comparative analysis with the most consolidated two-tiers model implemented in Germany (which is considered the benchmark), in some other European countries (France and the Nordic countries) and with the experiences of Asian countries and in particular of Japan. From the comparative analysis we try to understand whether differences in purposes and ways of implementation can be pointed out.

Keywords: Board of Directors, Ownership, Control, Corporate Governance

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1 The introduction of two-tier model in the Italian Legal System

In Italy, the introduction of a governance model to comply with the global Corporate Governance systems and with the provisions aimed at promoting the unique market and the spread of European culture, took place through several legislative actions since 2003, due to the implementation of the EU Directive 2001/86. It was Law No. 6/2003, "Reform of Corporate Governance", to introduce the first regulatory intervention. On this occasion, the legislature's purpose was to reconcile the divergence between the legislation for the listed and not listed companies, to incorporate the governance models existing in other countries, to ensure companies the free choice of the most suitable corporate governance system for their own management, administration and corporate control. The reform has introduced, next to the traditional one, two new models: a one-tier model and a two-tier model. All the three are characterized by a board of directors, whose tasks is to fulfil the main management functions and a control body that is identified in different ways in each of the three models. The control function in the traditional Italian system, is entrusted to the Statutory Board of

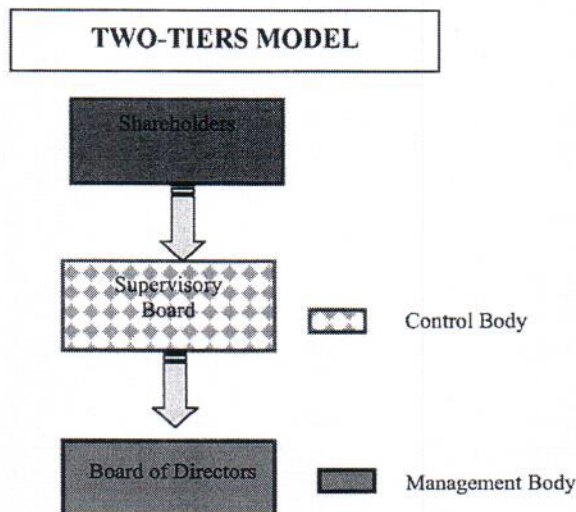
Auditors, while it is performed by the Audit Committee in the one tier system and by a Supervisory Board in the two-tier system.

The Italian law did not take a strong position about the Corporate Governance model in non-listed companies: this is proved by the lack of precision used to outline the new governance models as alternatives to the traditional Italian model. Articles are somehow brief and doesn't seem to recognize any urgency for companies to implement novelties. The introduction of the dual model takes into consideration the kind of internal relations between the different bodies. Some authors suspect a weakening of the controls on management because of the greater flexibility in the requirements of independence. Others on the contrary believe that it is the most suitable model for transparency between stakeholders - but in particular shareholders - and corporate bodies. In this model, we find the supervisory board which does not exist in the one-tier structure. It is elected directly by shareholders, and it has been given relevant functions to solve conflicts among and with stakeholders. The two-tier model belongs to the category of macro governance systems with multi-level structure. Its particular structure provides for the total separation of management function, from the one of the control.

Figure 1) shows the model structure and allows to represent the importance covered by the supervisory

board which is responsible for watching over all issues proposed by the board of directors.

Figure 1. Italian two-tiers model structure



Art. 2409-*duodecies* of the civil code provides that the Supervisory Board is composed of at least three members, they may be more, if expressly provided by the company's articles of association; the first members should be appointed in the incorporation deed and at least one of them must be enrolled in the Auditors Register; afterwards members are appointed by the shareholders. They shall remain in charge for three years and may be reappointed unless otherwise provided by the articles of associations. We need to point out that in the Italian two-tiers model no workers' representatives are included within the supervisory board while they are instead present in the two-tiers model of the other countries.

The Supervisory Board has a great influence on the company, because it has larger and more significant responsibilities than those assigned to other controller bodies. It is also referred to as "joint body of management and control" in reference to its skills extended to compliance and administration oversight, such as annual report approval, tasks that traditionally used to be performed by shareholders. The main functions of the supervisory board, according to Article 2409-tendencies civil code C.C. are indeed:

- To appoint and dismiss board of directors members and to determine their remuneration, unless this jurisdiction is conferred by the articles of association to shareholders
- To approve company financial statements and consolidated financial statements if existing
- To watch over the compliance with the law, with the articles of association and with good management standards; in particular, to monitor the adequacy of the design and the implementation of the management and accounting system and of the internal audit function

- To promote complaints against the board of directors when necessary

- To report at least once a year to shareholders on its oversight activity eventually pointing out omissions and censurable facts discovered

- To decide, if required by the articles of association, on strategic operations and on financial plans of the Company outlined by the board of directors

The articles of association may also provide for the allocation of the strategic supervision to the Supervisory Board which is then called to approve business and financial plans proposed by the Board of Directors. It is necessary an accurate and comprehensive partition of tasks assigned to the two bodies: to the Board of Directors is attributed the function of the industrial plans development, while to the Supervisory Board is assigned the task to discuss and approve them. Essentially management functions typical of the board of directors are broken in two: management itself is always in the responsibility of the Board of Directors but the supervision of management choices is attributed to the Supervisory board. The Italian National Bank intervened, requiring to all economic entities organized with the dual structure to regulate clearly the functions of each organ and for banks, it established the incompatibility for the Supervisory Board members to assume different positions from those of the control in other companies of the same group and in companies in which the bank holds indirect strategic participations.

In the two-tiers model, the Board of Directors performs the same functions as in the traditional system. The Board of Directors, as provided by the article 2409-*novies* of the civil code, is a collegial body formed by a minimum of two members that

cannot even be shareholders. They shall remain in charge for three years and may be reappointed if it is not otherwise provided by the articles of association and as for the Supervisory Board, the first members shall be appointed in the incorporation deed and the others are appointed by the Supervisory Board within the limits prescribed by the articles of association. This represents the main peculiarity of the model: it is the only Corporate Governance model which is not based on the direct appointment by Shareholders of the Board of Directors members, but on the indirect appointment through the interposition of a different body which is anyway expression of their will and composition.

It is worth to point out that in the Italian setting of listed companies that adopt the two-tiers system, it is not clearly specified that it is compulsory to have representatives of minorities in the board of directors. This seems to be not coherent with what is established by TUF article 147-ter which establishes on the other hand that at least one member of the Board of Directors needs to be expressed by the minorities and that all listed companies are asked to apply.

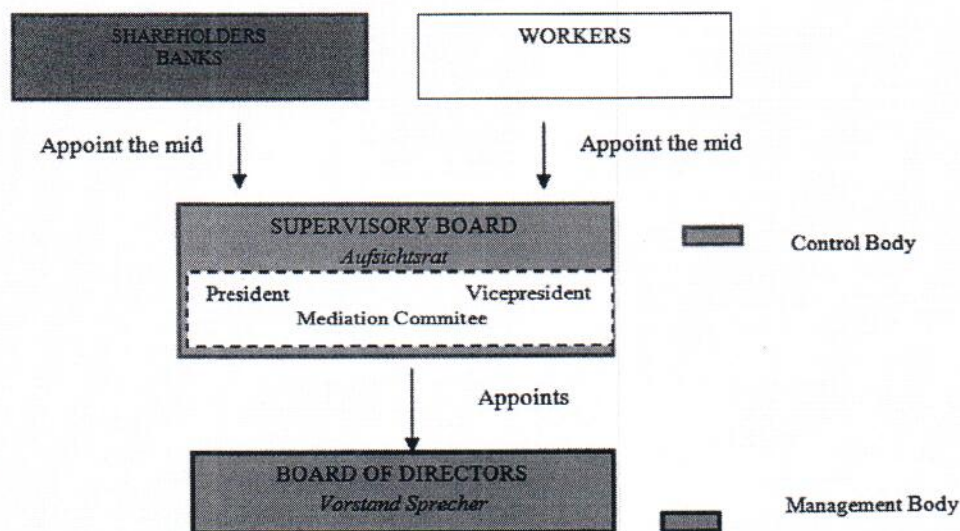
2 The structure of the German two-tiers model

Germany is the country of Rhine culture, which inspires the functional effectiveness of the two-tiers model of Corporate Governance. German economy

has always paid great attention to the protection and relations with banks and with the workers, developing and establishing with them a strong relationship that is configured at the corporate organization level. The importance recognized to these partners, gave way to establish a comprehensive governance structure where they could live and work together paying attention to the financial and productive aspects of the business for the success of the company.

The German model, also known as co-determination or co-management, refers to the legal principle that "conferring of primary resources gives the power to exercise the prerogatives of governance and control". This has been carried out in the direct presence of representative's workers and banks within the governance bodies. This standard is widely shared in the economic reality of the country and it has been codified by German law since 1951. The application of the co-determination and co-management system (Mitbestimmung) has brought a large support for this model of Corporate Governance therefore considered the guarantor for the participation in the corporate decisions. The structure of the German Corporate Governance model, is configured in figure 2, in which it is clear the important role played by the banks and by the workers who appoint members of the supervisory board, which in turn will nominate, and possibly revoke, the members of the board of directors.

Figure 2. German Corporate Governance model



According to German Law the election and composition of the Supervisory Board depends on the sector and on the size of the corporate enterprise. The first regulated disciplines date back to 1951, and was then improved in 1976, when it was defined the discipline related to the structure by type of activities of German companies. It was established that banks

and employees were responsible for the appointment of supervisory board members as follows:

- For companies with a number of employees between 500 and 1999, the appointment of one third of the components
- For companies with more than 2000 employees, the appointment of half of the components

- For iron coal and steel mining, with a minimum of 1000 employees, the appointment of half of the components

The remaining Supervisory Board component are appointed by shareholders. The legislation, however, also enshrines another constraint to be observed in the composition of the Supervisory Board which refers to the members elected by workers. It is established that when the Supervisory Board, consists of 12 or 16 members, two of them should be representatives of trade unions, while when the Supervisory Board consists of 20 members, trade union representatives have to be three. This structure was specifically sought to solve eventual determination difficulties within the control body, indeed the President and Vice-President must be elected with the vote of two-thirds of voting members of the Supervisory Board, entailing that an actual agreement between employee representatives and the shareholders is needed.

As shown in Figure 2 within the Supervisory Board a Mediation Committee is expected to be set up and involved in the election of the Board of Directors especially when it is difficult to find an agreement between employee representatives and shareholders. German legislature provides that the Supervisory Board shall appoint, among the members of the Board of Directors, a person in charge for social issues and workers: on him workers' representative cannot exercise any veto. The Board of Directors is set up as a collective body, since its components, usually professional managers who take the position of executive director have the same powers and responsibilities to jointly run the business. Within the Board of Directors it is pointed out a member acting as spokesperson (*Sprecher*) and therefore relating to the Supervisory Board president.

To prevent conflicts of interest the law forbids on one hand Supervisory Board members to perform meanwhile as executive director in the Board of Directors and on the other hand to enrol in the Supervisory Board more than two members that in the past have been part of the Board of Directors.

Proper working of two tiers Corporate Governance model is based on the continuous exchange of information between the two bodies, which are required to consult each other and to debate about strategies to be or being implemented. The Board of Director is asked to correctly communicate transferring all the necessary information to the Supervisory Board, while the Supervisory Board is given the power to ask for information in the event directors don't behave with full transparency.

New European Community frameworks have imposed all European countries to revise and update their Corporate Governance structures to enforce stronger transparency and accuracy in financial annual reports. In Germany a special committee within the Supervisory Board has been introduced to reach the goal. This is also required to evaluate the independence of the external auditor.

3 The dual model in other European countries. Evidence from France and the Scandinavian area

The French experience related to Corporate Governance has been different from other European countries, but to date, the effects introduced by the new corporate regulations are almost similar to the Italian situation. French economic environment consists of a high number of small and medium-sized firms often with a restricted ownership structure which can be considered family businesses. France, as well as Italy, is a country with a hybrid system of Corporate Governance because a part of the running rules can be described referring to models and disciplines typical of other countries and because companies can choose whether to adopt the one-tier model or the dual model. It is up to the companies to choose the preferred model to be adopted based on their needs and depending on their business conduct and financial dynamics.

French companies show to like best the one-tier model which keeps being adopted despite the possibility of using the two-tiers system. It seems they have no intention to retrace their steps and standardize their governance to the German model. The implementation of one-tier model was unexpected for the characteristics of the model – typical of common law countries and not of civil law countries such as France – but more than this it was surprising the almost total disregard shown for the alternative system introduced in the country. In fact, despite the two-tiers system has been introduced since many years, it still represents only a kind of “new” alternative which however, didn't meet the assumed success. French system has favoured the flexibility and immediacy guaranteed by the one-tier system, rather than having Directors subjected to new control mechanisms which are felt as resulting in additional costs and excessive bureaucracy at the expense of business results. On the contrary one-tier system is considered allowing medium-sized and family companies to deal more effectively with all the problems and obstacles that arise in the everyday business life, by identifying the property with the Directors part of which anyway need to be independent and professionals.

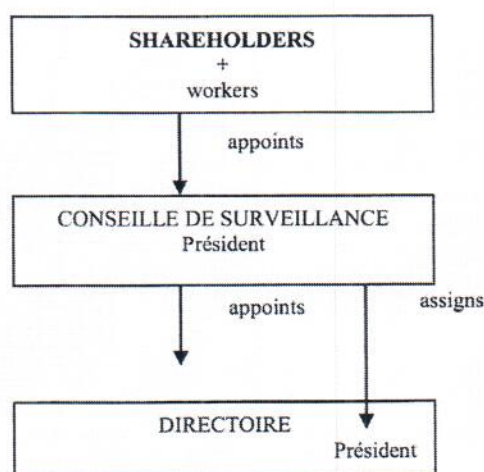
The establishment of the two-tiers model introduced in France in 1966 did not represent a tool for an efficient and effective management to improve companies success. The structure of the model is specular to the Italian one already described. Shareholders appoint members of the “*Conseil de Surveillance*” (Supervisory Board) and this second appoints a *Directoire* (Board of directors) composed of maximum five members (seven in the case of listed companies). If the company's capital is less than €150.000 the *Directoire* can be replaced by a sole administrator. The *Directoire* appoints a chairman and a vice-chairman who are the only legal representative of the company unless the “*Conseil de Surveillance*”

permits, as required by articles of association, the same power to the other members. For Directors an age limit is usually established by the articles of association, and if it is not provided, it is fixed at 60 years. The mandate duration varies from two to six years and again if not required by the articles of association it is assumed to be of four years.

In France, there is not the institution of co-management as in Germany and northern European

countries, but there are situations in which workers have the right to participate to the management of the company. In both systems of governance articles of association can provide some workers representation in management bodies, it is compulsory when workers represent 3% of shareholders and in government companies.

Figure 3. French two-tiers model



The German two-tiers model spread in nearby geographical areas. It has been implemented in Austria, in The Netherlands and in Luxembourg. In this area in fact the importance of workers contribution within companies governance bodies seems to have been enhanced. Due to its widely accepted adoption it is also identified as the Rhine model. Another area interested is represented by other Northern European countries such as in the Scandinavian ones. These countries used to be traditionally oriented towards the one-tier governance system, but in recent years they have been interested by a new trend as they have been introducing in their legislation the possibility for companies to choose whether to adopt the two-tiers model or to maintain the embedded system. The impact of these changes can be attributed to the economic dynamics. Changes in business environment have made a progressive evolution in Scandinavian countries governance system a necessary step to be able to implement structures coherent with achieving the local growth objectives.

Finland, for instance, in the last years of the last century has been interested by an important economic recovery and as a result the attention to the issues of corporate governance has resulted in the publication of Limited Liability Companies Act in 2006. The need to improve the protection for minority shareholders and for creditors lead up to living the distinction between

large and small firms out of consideration when choosing the corporate governance system. The Finnish law hence provides that corporations can adopt one-tier system or vertical two-tiers system despite company size, while in the past it the implementation of the dual system was allowed only to large companies expressing a special clause in the articles of association.

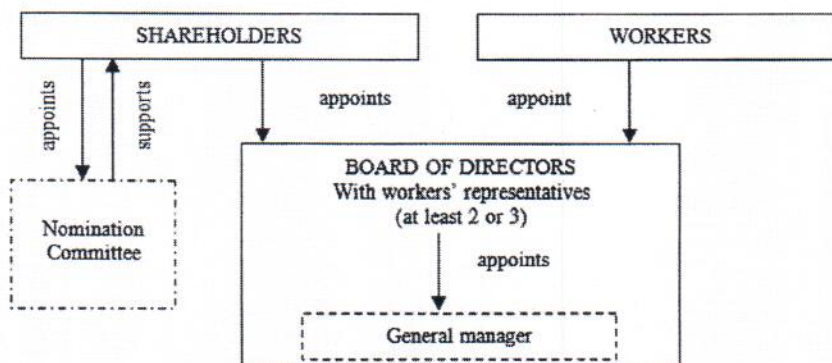
The Finnish Supervisory Board isn't characterized with broad powers as the German two-tiers governance system; it plays a sort of secondary role in management of the company. In Finland, differently from other Scandinavian countries, although the law provides for the participation of workers in management, their presence proves to be less intense and significant than observed elsewhere.

Norway adopted since 1976 the Companies Act to support international trade adapting internal corporate governance to the Community legislation. In 2004, it was introduced a corporate governance Code of Conduct to improve relationships of companies with financial markets as well with stakeholders in order and to increase the competitiveness of Norwegian companies in the international economic markets. Norwegian companies prefer one-tier model where the functions of government and control are both attributed to the Board of Directors, but for companies exceeding 200 employees it was introduced an additional body called "corporate

assembly” getting the structure more similar to a two-tiers system approach. This last is indeed composed by twelve members, two-thirds of which are elected by the assembly and one-third is elected by workers. The central role recognized to workers makes the Norwegian companies corporate governance near to the co-determination value characterizing Rhine cultures even if the model applied are not exactly alike.

Swedish Corporate Governance typical configuration is characterized by the presence of a national shareholder (as a result of the strong centralization), which is responsible for the appointment of the Board of Directors and also for the supervision and the control of the Board of Directors of the CEO and of other managers activity.

Figure 4. Swedish Corporate Governance model



The Nordic governance model pays a particular attention to the shareholders' meeting which covers directly important decision-making roles performed in other jurisdictions by specific Board of Directors Committees or by executive bodies. Shareholders' meeting are indeed used on one hand to establish strategic guidelines and to pretend specific conducts and on the other to relieve the Board of Directors of the responsibilities coming from its performances. The principle of co-determination is guaranteed by the process followed to appoint the Board of Directors members: as expressed in Figure 4, shareholders' meeting is responsible for the majority of the appointments and employees are entitled to elect at least two or three Board members depending on the size of the company. The law, in observation of the separation of the control and management functions, provides that the Board of Directors appoints a member of the Board, or somebody who may be external to the Board, as General Executive Manager.

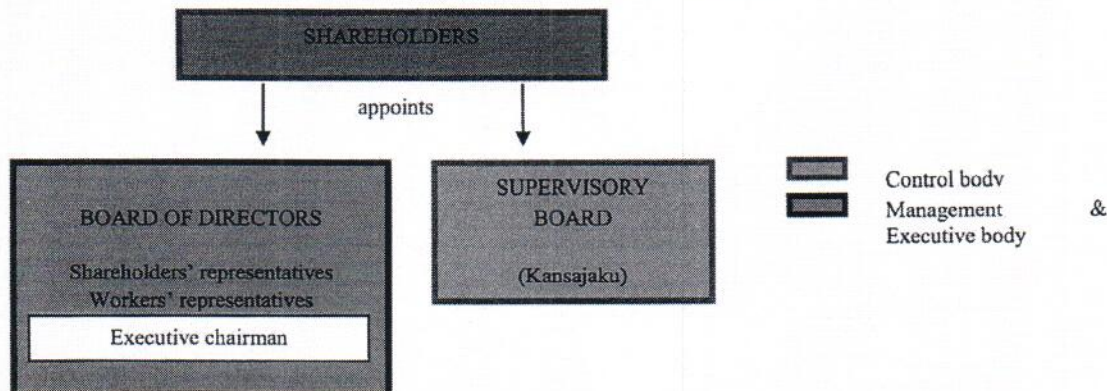
4 The two-tiers Japanese Corporate Governance model

Before the Second World War important entities called *zaibatsu* were present throughout the industrial, commercial and financial system. These realities, firmly settled and widespread in the area, were controlled by important and wealthy Japanese families, independent from the banks' influence and from the presence of public investments in them. Their existence was called into question since the American intervention as at that time *zaibatsu* - given their strong dependence on the control of a few wealthy

families - started being evaluated as an obstacle to the market competition and the cause of an unequal and unfair income distribution. As a result, Japan attempted to be able to obtain adequate economic structure that on one hand enshrined the strong presence of Japanese culture in economic life but on the other hand encouraged the necessary openness to foreign investors. This goal was reached establishing a different kind of organizations called *keiretsu*, which were characterized by a weaker families influence and at the same time by the active important role of banks. Companies built long term relationships with one or a few banks which often became shareholders, even holding majority shares, and consequently played a dynamic role in companies management. As the model grown into a common phenomenon a dense system of cross-shareholdings got created.

Japan, since the end of the second World War, introduced the two-tiers Corporate Governance model here described as the German system. These two countries - Japan and Germany - are distant for both geographic and cultural factors, but seem to have in common the ability to manage development supporting and balancing internal relations and making them become a key strength to obtain economic growth. The basic concept of the dual model is, as already commented *supra*, the separation between the two functions - management and control - but differences have to be searched in ways it is implemented. Figure 5 shows the structure of the model.

Figure 5. Japanese “horizontal” two-tiers model



In Japan company's management is open to workers who are usually present on both the board of directors and the supervisory board. Shareholders appoint the members of both corporate governance bodies. Management has to be conducted on shareholders' interests. Japanese model is different from the Rhine model as the first one is "horizontal", while the second one is "vertical" meaning that in the first both bodies are appointed directly by shareholders while in the second there is a kind of climbing down path which takes from the Shareholders to the Management Board passing through the Supervisory Board.

Considering Figure 5 we could say that the "horizontal" Japanese model seems as a matter of fact to have a lot in common with the Italian traditional model. What makes however the two structures strongly different is the composition of the two bodies as in Italy workers do not find any representation in the two Boards so that it is not possible to say that governance is inspired by co-determination standard.

Half of the Japanese Board of Directors members are employees who are completing their career in the company and at the same time are placed in executive positions. Often, before their appointment as Directors they had the opportunity to interface with the Board members and with the Executive Chairman, participating to strategic projects. Their presence is very important for the continuous flow of internal communications that generate shared experiences, sense of belonging and as it helps to better convey the goals to be reached and the standard to be respected.

The members of the Supervisory Board, *Kansajaku*, are appointed at the Executive Chairman discretion. In fact, it is the Executive Chairman who

presents to the shareholders the selected candidates. His strong influence does not ensure an effective representation of workers and in any case looks like making workers appointed more compliant than freestanding from the Chairman's opinions. Often they are managers who have failed to join the Board of Directors despite their qualifications. The procedure Supervisory Board gets appointed represent one of the differences with the German two-tiers model, where the presence of workers is imposed by law. Moreover it has been criticized because of the lack of external and independent members and it resulted in representing an obstacle to foreign investors establishment. To deal with the situation and trying to adapt to international trends, Japan promoted significant and innovative reforms on corporate governance issues which included new laws and the introduction of codes of conduct.

The most significant upgrade was the introduction of the one-tier system (inspired by the Anglo-Saxon tradition) in 2002, as an alternative model to the described horizontal two-tiers one.

In this model, typical of the Anglo-Saxon tradition, the Board of Directors covers the different role typical, as already described, of this kind of structures. It remains in office for one year and it is responsible for management and for control with the support of three internal committees dedicated to remuneration, nomination and internal control.

In the Japanese context anyway, even though since 2006 the implementation of the model has been extended from only large companies to all companies no matter the size, the one-tier model was barely chosen and consequently it did not represent the solution to get closer to foreign investors.

Figure 6. The Japanese one-tier model

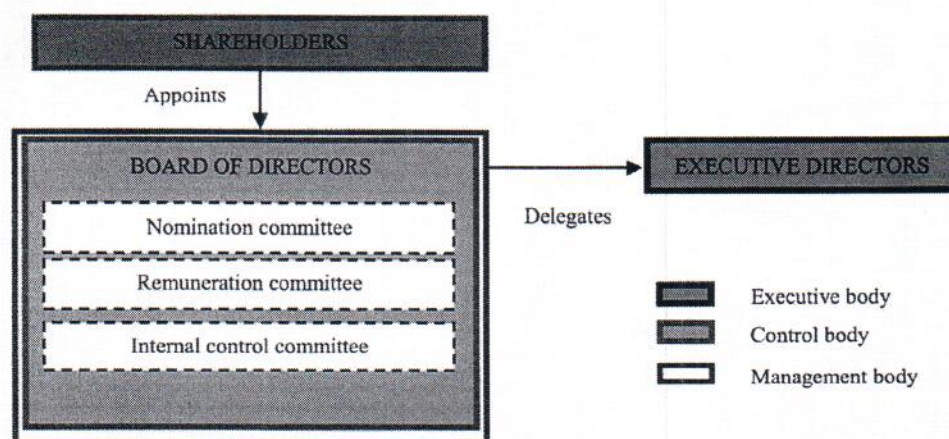


Table 1. Main features of the two tiers-model implemented in the countries examined

	GERMANY AUFSICHTSRAT	FRANCE CONSEILLE DE SURVEILLANCE	JAPAN KANSJAKU	ITALY SUPERVISORY BOARD
CONTROL BOARD	The number of the members and its composition depend on the companies size. It is appointed by the employees and by shareholders. Within this body there is a committee which appoints the board of directors.	Appointed by shareholders.	The Executive Chairman presents to the shareholders the selected candidates. His strong influence does not ensure an effective representation of workers and in any case looks like making workers appointed more compliant than freestanding from Chairman's opinions	Formed by a minimum of 3 members and appointed by shareholders
MANAGEMENT BOARD	VORSTAND Appointed by the Aufsichtsrat. It is formed by professional managers with the supervision of the Executive Director. The president is the Spokesperson of the Board (Sprecher) and relate to the President of the Supervisory Board.	DIRECTOIRE Formed by 5 or 7 members appointed by the Conseil de Surveillance. The Directoire appoints a Chairman and/or a Vice-Chairman who are usually the only legal representative of the company.	BOARD OF DIRECTORS Appointed by shareholders. Half of the members should be employees.	BOARD OF DIRECTORS Formed by at least 2 members and appointed by the supervisory board.
PECULIARITY	Continuous exchange of information between the two bodies. Balance between workers' and shareholders' representatives to implement Co-Determination.	There are situations where workers have the right to participate in the management of the company, but it can't be considered Co-Determination.	It has been criticized because of the lack of external and independent members, due to the strong power of the Executive Chairman. In 2002 it was introduced as an alternative to the one-tier model, but it was barely implemented.	There are no workers at any level. This happens in a context where the Italian founder of Italian "Economia Aziendale" Gino Zappa and all his scholars throughout the Italian Academy kept teaching for decades starting from mid-twentieth century that, to get wealthy companies lasting for long time, not only shareholders should be involved in companies governance, but a stakeholders approach is needed and at least workers should enter the board
TIME OF INTRODUCTION	Widely diffused since 1951.	Introduced in 1966.	Introduced since the end of the second world war.	Introduced in 2003.

5 Conclusions

The two-tiers model was considered helpful to manage the relationship between ownership and management and as a consequence it was considered a good governance structure for family businesses. The experience of the Rhine countries attests that in those countries the vertical two-tiers model has allowed workers to play a role in companies' administration having the opportunity at least to express their point of view at top levels in ordinary situations as well as in crucial moments. This has been positively experimented in France and by Scandinavian countries. In the Japanese context, the horizontal two-tiers model produced a special balance of interests between on one side shareholders – wealthy families and banks – and on the other side workers, making it possible: i) to build a common idea about the company itself and, ii) to find a way to cooperate (despite the criticized strong position of Executive Chairman).

The EU decision to introduce the two-tiers system is therefore the result of a global international experience that has qualified the model as flexible, adaptable to cultures different from each other and suitable to reconcile opposite interests. The role of the Supervisory Board, watching over the Board of Directors, was indeed expected to ensure transparency and efficiency of management operations. In spite of this, the development and economic consolidation obtained from the two-tiers model in Rhine Cultures Countries and in the other countries here analysed did not take roots in the Western Europe cultures even if a relevant part of the business is made up of family businesses. The two-tiers model seems not having been implemented due to the excessive power and to the excessive costs associated with the introduction of the Supervisory Board. In Italy, for example, the two-tiers model was rarely chosen. From 2004, in Italy, only eight companies have implemented the dual model and what is even more significant is that half of them recently preferred to go back to the traditional governance model. Indeed on 31 August 2013, Italian companies structured according to the two-tiers model result to be four. Two of them belongs to the banking sector (UBI, Intesa) and the remaining two are A2A (a public utility company) and SS Football Lazio.

As seen the basic structural characteristics of the implemented two tiers model resulted different among the different EU countries. Table 1 summarizes the main differences observed.

This resistance can represent a lost opportunity. As the Italian founder of Italian "Economia Aziendale" Gino Zappa and all his scholars throughout the Italian Academy kept teaching for decades starting from mid-twentieth century that, to get wealthy companies lasting for long time, not only shareholders should be involved in companies governance, but a stakeholders approach is needed and at least workers should enter the board. The two-tiers model aimed at reaching exactly this goal, protecting

the involvement of shareholders as well as of workers as economic agents participating in the company management.

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