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Eppure, non si muove: Legal Change, Institutional Stability and Italian Corporate Governance

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Prevailing theories in political economy hold that a coalition or political party, acting through parliament, can break down institutions of stable shareholding. In spite of extremely favourable conditions in the late 1990s – the election and durable rule of a leftist government supported by a transparency coalition, a bureaucratic elite that favoured institutional change, and substantial state shareholdings which the government could privatise in pursuit of its objectives – these reforms failed to affect the concentration of shareholdings among the largest private companies in Italy. This disjuncture between legal change and actual practice in Italian corporate governance suggests that current theories of institutional change in corporate governance systems are incomplete. The focus of inquiry needs to turn to the political resources of those who support the existing system: managers and large shareholders.

Dominant theories have been known to stand for some time after overwhelmingly disconfirming evidence against them is discovered. Galileo is not the first scientist to have discovered this unfortunate fact, though he is often credited with the most memorably disgruntled riposte to it. After being forced to recant his theory that the earth revolved around the sun, he is alleged to have mumbled to himself '*Eppure, si muove*' (And yet, it still moves) – the earth, that is, against the expectations of the dominant geocentric theory of Galileo's time.

What is striking about the pattern of concentrated share ownership in Italy is not that it moved between 1996 and 2005, but that it did not. Just as the fact of the earth's movement belied dominant theories of geocentrism, so does the stability of Italian patient capital directly contradict currently prominent theories of political economy about the mechanisms of

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institutional change in advanced capitalism (Roe 2003; Gourevitch and Shinn 2005). This article will review clear evidence that shows the stability of this system despite the emergence of a strong Italian transparency coalition among workers, shareowners, and government technocrats (Deeg 2005; Gourevitch and Shinn 2005); despite drastic changes in the quality of laws protecting minority shareholders, enacted by a centre-left coalition that governed Italy continuously between 1996 and 2001 (Cioffi and Höpner 2004; cf. La Porta *et al.* 1998); and despite the ability of these party and bureaucratic leaders to exert significant influence on the character of corporate ownership through a large-scale privatisation process (Deeg 2005; cf. Tiberghien 2007). During the last decade the Italian political economy experienced a perfect storm of the factors that should destabilise domestic systems of patient capital, if the theories currently endorsed by political scientists are correct. Italian stable shareholding weathered that storm in much better health than did those theories.

The failure of the dominant political approaches to explain stability in the Italian political economy itself requires an explanation. Part of that explanation, I will contend, lies in the systematic underestimation of the power of large shareholders and the managers they support to resist state-led attempts to promote institutional change. Political scientists have fallen back on three complementary explanatory stories to construct theories of change for systems of finance and corporate governance.[1] A new coalition pushes through legislation to disrupt the existing system (Gourevitch and Shinn 2005); a new government driven by partisan objectives pushes through legislation to disrupt the existing system (Cioffi and Höpner 2006); or a set of government bureaucrats directs the regulatory or privatisation processes so as to disrupt the existing system (Deeg 2005). All of the major political explanations focus on the importance of seizing the reins of the state and effecting change through the *formal* channels of state policy-making.

These approaches either ignore or downplay the power resources of those who actually own large blocks of shares and want to maintain their influence in the economy, a group known as blockholders. Seizing control of the legislative apparatus and making new laws that regulate financial disclosure does not automatically disempower managers and blockholders. So long as their perception is that the existing system works for them, they have no reason to change it. To the extent that the law changes, we would expect large shareowners in this situation to seek alternative ways of exercising continued disproportionate control of their companies, and the managers of these companies to do the same thing. To the extent that privatisation or other shocks dilute the direct power of large blockholders, we would expect them to seek alternative instruments to maintain their voting power over companies. If they are able to use such measures to insulate themselves from politically mandated change, political scientists may need to recognise that the failure of their theories of institutional change in the Italian case has broader significance. Even in a world of global equity markets, domestic rules of the game are often determined outside of parliament.

The first part of this article reviews recent work on the Italian political economy along with broader comparative work in the political economy of finance and corporate governance that deals with the Italian case (see also De Cecco 2007). The second section evaluates the major reforms undertaken in the second half of the 1990s – privatisation and the Draghi Law – both in their content and in their subsequent effects on the structure of Italian capitalism. In the third part of the article, I consider the impact of two significant scandals – at Parmalat and at the Bank of Italy – on the formal and informal rules governing the Italian political economy. The fourth section assesses the findings of the Italian case in comparative perspective and proposes avenues of future research for better understanding the political resources of blockholders.

Italian Corporate Governance and Theories of Political Economy

Over the past decade, Italian capitalism has undergone numerous changes: in regulatory structure, macroeconomic regime, and integration into European and global financial markets. The goal of this article is to gauge how resilient the institutional structure of Italian finance and corporate governance has been in response to these changes. To do so, this article stresses as most fundamental to Italian capitalism the concentration of ownership and control, because of the weight accorded to this concept in recent research on the varieties of capitalism. This work stresses that finance and corporate governance – how companies procure money and how their shareholders exercise control over management – comprises one of the central institutional differences between coordinated market economies (CMEs) and liberal market economies (Hall and Soskice 2001; Amable 2003). In liberal market economies, equity markets serve as an important source of finance for companies, and management in these companies is judged by indicators that markets can readily digest, such as quarterly earnings statements. In contrast, in coordinated market economies, companies are much less dependent on such short-term indicators, and much less subject to the threat of hostile takeovers, because of the widespread feature of patient capital. Patient capital denotes owners (i.e., shareholders) who are not solely dependent on short-term indicators of performance for their information about the firm (Hall and Soskice 2001: 22–3; Streeck 2001: 8). Patient capitalists are not infinitely patient, but their concentrated stakes in a company give them an incentive to develop monitoring mechanisms to assess the long-term strategy of management.

Italy's fit within the typologies of comparative political economy has always been awkward, at least partly as a result of its internal diversity (Shonfield 1965; Locke 1995). Yet most work dealing with finance and corporate governance in Italy has stressed the feature of patient capital, either in the guise of state ownership or in the role of the family firm. Vincent della Sala (2004: 1045), for example, described the Italian political economy as a form of 'dysfunctional state capitalism', in which the state plays an important role in share ownership, while being subject to the well-known shortcomings of public oversight and enforcement in Italy (cf. Ferrarini 2005).[2] By contrast, recent work by Andrea Melis (2006) underlines the central role of family ownership of large shareholdings and pyramidal ownership structures in Italian capitalism (see also Pagano and Trento 2002; Aganin and Volpin 2003). This article focuses more on this latter characteristic, because it emphasises what is most distinctive about Italian capitalism in comparative perspective: the extreme concentration of control made possible by pyramidal ownership structures, which create 'the possibility of controlling vast resources with limited amounts of capital' (Bianchi *et al.* 2001: 154).

To understand some of the implications of pyramidal ownership, consider the following hypothetical example. Company X may own 50.01 per cent of both companies Y and Z; each of those companies, in turn, may own 50.01 per cent of the shares of three other companies. Y owns such stakes in A, B, and C, while Z owns such stakes in companies D, E, and F. Company X is the effective controlling owner of six companies (A–F) in which it owns no shares itself. It maintains this control by virtue of its majority ownership of Y and Z. Suppose, then, that the management of Company A sells some of its assets on extremely favourable terms to Company X (which controls Company A indirectly, through its control of Company Y). If minority shareholders in Company A want to contest the decisions of management to sell the company's assets on such favourable terms, which effectively expropriates some of the assets of those minority shareholders, they have little recourse. Company Y will support the deal (since it is controlled by X), even if it has no direct stake. Pyramidal ownership schemes are not unique to Italy, but their prevalence in the Italian ownership structure is marked in international comparison (Bianchi *et al.* 2001; Melis 2006).[3]

Although corporate governance regulation was long the exclusive province of lawyers and financial economists, recent contributions by Mark Roe (2003) and by Peter Gourevitch and James Shinn (2005) have highlighted in dramatic terms the deeply political character of corporate governance regulation. Both books contend that ownership concentration, as an indicator of patient capital, has been constructed and maintained through the conscious efforts of political actors. Roe attacks the influential thesis of La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998; hereafter LLSV), which holds that the quality of corporate law is the central determinant of ownership concentration.[4] Roe argues that patterns of corporate concentration descend not mainly from legal families, but instead from the political context of the countries in which they are found. Those governments that have attempted to protect labour from the vicissitudes of the market have also, with that same goal in mind, attempted to protect managers from their diffuse shareholders. Separating ownership from control makes it easier for managers to take account of other stakeholders – above all, employees – in their decision-making process. Thus, Roe argues, a significant proportion of the variation we observe in the extent of patient capital in the richest OECD countries depends on the political protection of labour. Ownership concentration, he claims, is a political construction of social democracy.[5]

Gourevitch and Shinn (2005) develop Roe's central insight, that the patterns of patient capital that we observe in cross-national comparison have their roots in politics. Their argument is complex, but its principal claim is that there are three groups in society that fight over corporate governance: owners (shareholders), managers, and employees. The outcome of the financial system depends on which group or coalition of groups emerges victorious. There are many possible permutations of these coalitions, but two are of importance in discussion of the Italian case. When managers and workers ally against owners, the result is a corporatist compromise that should favour concentrated shareholding, as was the case for much of the post-war period in Italy (cf. Rajan and Zingales 2003; Pagano and Volpin 2005). When owners and workers ally against managers, the result is a transparency coalition that should lead to diffuse shareholding. As Gourevitch and Shinn (2005) also note, we would expect it to be more difficult to unravel concentrated shareholding in proportional representation voting systems, because such systems create more veto points: it is hard to get a coalition to adopt sweeping changes under a proportional representation voting system, as at least some of the interests represented in the government are likely to be adversely affected by such changes (cf. Pagano and Volpin 2005). In this political analysis, thus, the situation that seems most likely to lead to the breakdown of the Italian corporatist compromise is one in which an electoral reform allows for the emergence of government with a clear mandate and reforming programme, and one in which labour deserts the side of managers and joins shareowners in pursuit of greater transparency.

Martin Höpner and John Cioffi (Höpner forthcoming; Cioffi and Höpner 2006) have developed an approach that draws on Roe, and Gourevitch and Shinn, and which is highly relevant to the Italian case. For Cioffi and Höpner (2006), it is the political parties of the left which have shown the primary interest in breaking down ownership concentration, not in building it up, as per Roe's argument. The centre-right and its allies built the post-war systems of patient capital in France, Germany, and Italy, and they derived the rents from it, through their close cooperation with business. Thus, parties of the left were the natural opponents of patient capital, and when the global context created an opportunity for those parties to push for legislative change in the 1990s, they jumped at the opportunity. Moreover, Cioffi and Höpner (2006: 15) claim that control of the governmental levers of power bore fruit for the left, in terms of creating the fundamental change in Italian capitalism they sought: 'the decade of reform by the centre-left [begun in the 1990s] significantly altered Italian capitalism'. In particular, the Draghi reforms, which transformed the scale of minority shareholder protection in Italy (see below for details), ushered in a legal climate hospitable to the transformation of the Italian system of patient capital. For Cioffi and Höpner (2006), it is the partisan character of these changes, not the coalitional politics behind them underlined by Gourevitch and Shinn (2005), that is the driving causal force behind changes in corporate governance.

If state-led political changes can unleash change in the system of patient capital, as these scholars have suggested, then the Italian case would seem an ideal test. Not only did a government of the left come to power (backed by a transparency coalition of labour and minority shareholders), but it came to power with a large group of state-controlled enterprises it could privatise to achieve its professed goal. One could imagine a more propitious testing ground for these political theories only with a great deal of creativity. If Italian patient capital was able to withstand the major changes adopted during the 1990s, though, then these theories of political change in finance and corporate governance may be in need of revision.

Have Regulatory Changes Fundamentally Transformed Italian Capitalism?

To assess the changes in Italian capitalism wrought by the accession of the centre-left government headed by Romano Prodi in 1996, we need to know what that government did as well as what effect it had on the structure of patient capital in Italy. This section briefly reviews the policy tools deployed by the government, focusing especially on those instruments most emphasised in the theoretical literature: privatisation and the 1998 Draghi Law on Corporate Governance Regulation. It then examines the impact of those changes on the actual practice of shareholding in Italy.

Privatisation and the Draghi Law of 1998

Privatisation and regulation represent two alternative vectors through which governments can influence the structure of shareholding. Privatisation definitionally takes a large public stake and puts it into private hands, and the conditions of privatisation influence how widely dispersed ownership of formerly state-owned shares is likely to be. Regulation in the area of corporate governance influences the transparency of ownership: how the lines of authority are drawn, what bids and ownership stakes must be made public, and what cooperative pacts exist among shareholders to exercise effective control. These regulations also influence the ability of minority shareholders to call managers and large blockholders to account. The transparency coalition described by Gourevitch and Shinn (2005) thus pits small shareholders and labour – both of which favour transparency of control mechanisms – against managers who wish to limit the ability of those actors to restrain their autonomy.

In Italy, privatisation and corporate governance reform were pushed both by neo-liberal state bureaucrats as well as by parties of the left (Cioffi and Höpner 2006). Richard Deeg's (2005: 525) analysis shows that a transparency coalition emerged in Italy, but that its strength depended in part on the 'rise of a reformist elite within key state institutions'. These reformers, concentrated in the Italian Treasury and the Bank of Italy, 'set out to overhaul Italian capitalism through privatisation and the modernisation of the financial system, including the expansion of the stock market and the dispersion of corporate governance in Italy' (Deeg 2005: 529).[6] A 1994 law adopted rules for privatisation that would limit the concentration of ownership of any single shareholder to 5 per cent of equity, a measure which allowed the Treasury to embark on 'the largest privatisation programme in the world during the 1990s' (Deeg 2005: 531). This privatisation programme contributed significantly to the dramatic growth in overall stock market capitalisation in Italy between 1995 and 2000 (Bortolotti and Siniscalco 2004: 71). This market growth went hand in hand with the broad increase in shareholding within the Italian populace during the second half of the decade (Della Sala 2004: 1048).

The passage of the Draghi Law in 1998 represented a thoroughgoing reform of Italian corporate law and a substantial victory for the transparency coalition that pushed it through parliament (Deeg 2005).[7] It adopted a series of requirements that significantly increased the regulatory protection afforded to minority shareholders. These measures included a provision that all shareholder agreements – that is, pacts pledging several large shareholders to create an effective blocking or controlling group – be publicly disclosed; that any shareholder with 5 per cent of shares could bring suit against the directors; that shareholders could use proxy voting (making it easier to build up opposing blocs to management); allowing voting by mail; and reducing the threshold required for an extraordinary shareholders' meeting from 20 to 10 per cent (Melis 2006). The law also changed the auditing system and required any takeover bidder acquiring more than 30 per cent of shares to make a bid for all ordinary shares. This dramatic legal change moved Italy from the lowest score on the LLSV index of minority shareholder protection to the same score as the United States and the United Kingdom, considered paragons of best practice in this area (Pagano and Volpin 2005). If laws bring about institutional change, the Draghi Law certainly had the sweep and the content to do so.[8]

Empirical Trends in Italian Shareholding Concentration

What has been the effect of the aforementioned privatisation and legislative changes on the structure of the Italian system of finance and corporate governance? In this section, I will look at several available indicators that shed light on these effects. Their overall story can be summarised in three words: *non si muove*.

If patient capital is central to the Italian model of capitalism, as many have argued, then we should look at changes in ownership concentration as the most obvious available indicator of patient capital (Culpepper 2005). For large shareholders to succeed in insulating managers from the short-term movements of share prices, they need to have enough shares to impede hostile takeovers.[9] Table 1 presents data for the 30 largest Italian companies by market capitalisation in 2000, for which data were available in three time periods: 1996 (the year of the election of the centre-left government led by Prodi, and two years before the passage of the Draghi Law); 2000; and 2004/5. The first row lists overall ownership concentration, including state-owned companies that were privatised during this time period. The second row includes only private companies.

Two things are immediately striking about this table. First, the privatisation initiative undertaken by the government during the 1990s had a real effect – on the concentration of formerly majority state-owned firms. The average state share of ownership in the largest majority state-owned companies (such as Telecom Italia and ENEL) dropped from 68 per cent in 1996 to 27 per cent in 2004/5. This of course means that half of those formerly state-owned companies still had large owners (often the state) with ownership stakes of more than 30 per cent in 2004/5. Moreover – and this is the second noteworthy fact in the table – column two shows that there was *no fall at all in the ownership concentration of privately owned companies between 1996 and 2004*. The private edifice of Italian patient capital remained unmoved by the legislative measures undertaken to change it fundamentally.

TABLE 1
AVERAGE OWNERSHIP CONCENTRATION OF 30 LARGEST ITALIAN COMPANIES, 1996–2005

	1996	**2000**	**2004/5**	**Change, 1996–2004/5 (%)**
Ownership concentration	43.7	35.6	33.0	−24.49
Ownership concentration, excluding privatised companies	32.4	34.4	33.2	0.02

Note: these data include top 30 firms (based on 2000 market capitalisation) for which information was available over the three time periods. The largest company by market capitalisation in 2000 was Telecom Italia Mobile (TIM), which was 61% state-owned in 1996, a wholly owned (100%) subsidiary of Telecom Italia in 2000, and majority owned (56%) by Telecom Italia in 2004/5. It is excluded from the data above, because I excluded all 100% owned subsidiaries from the data. Were it to be included, the figures for ownership concentration in the first column would be slightly higher than they are in this table.

Source: Data collected from company reports and the Amadeus database for 2000 and 2004/5; most data from 1996 comes from the database of La Porta *et al.* (1999).

The story told by the data on ownership concentration is consistent with other sorts of evidence on Italian shareholding. Corrado and Zollo (2006) undertake a structural network analysis of Italian ownership networks between 1990 and 2000. Network analysis is often difficult for non-specialists to interpret, but it focuses on the dispersion of a network and the robustness of its centre (the main component). Their analysis focuses on the network ties among owners (each of whom is presumed to have a tie if they own stakes in the same company) and owned companies (each of which is presumed to have a tie if they have at least one shareholder in common). They show that for both types of networks, privatisation during the 1990s led to some destructuring, which means that the number of ties decreased, relative to the size of the networks (Corrado and Zollo 2006: 341). Yet, as indicated also by concentration data, the destructuring effects of privatisation had little impact on the core of the two networks. The central part of the two networks remained largely stable, and 'no significant entries of foreign companies were observed, with the main component largely dominated in both years [1990 and 2000] by domestic companies' (Corrado and Zollo 2006: 342). The effects of privatisation on the ownership of privatised companies, in other words, were significant, and this is reflected in greater fragmentation; their effects on the overall character of ownership networks in Italy were marginal.

It might be plausible to argue that the lack of change in non-privatised companies does not equate to lack of change in Italian capitalism, since state ownership was an important component of the Italian post-war system of finance (Bianchi *et al.* 2001). For that to be true, though, we would need to observe some indicator showing that privatisation has changed the rules of the game for all traded companies. There appears to be little such evidence. Melis (2006) reports data from CONSOB, the Italian market regulator, for all Italian listed companies. Those data show that the number of majority-controlled companies has declined sharply since 1996, from 67 per cent of companies then to 33 per cent of companies in 2004. Yet the category of companies classified as under 'working control' (i.e. effective control under 50 per cent) has more than doubled, and the use of formal alliances between owners to control companies (shareholder pacts) has tripled during the same time. Privatisation has driven down the average size of the largest share, but it has not altered the dominance of a model of concentrated control of listed companies. The Draghi Law, while increasing both transparency and minority shareholder protection, has not significantly weakened the controlling power of large shareholders in Italy.

Have Recent Scandals Fundamentally Transformed Italian Capitalism?

Privatisation and the Draghi Law are the most formidable weapons that politicians have employed to try to change the system of Italian finance and corporate governance since 1995. Yet the public face of Italian corporate governance in recent years has been dominated by two names: Parmalat and Antonio Fazio. It is important to consider whether the scandals these names connote have had an important impact on the evolution of the organisation of Italian ownership structures.

Parmalat was a family firm that had grown by the 1990s into an internationally important dairy company, appearing among the top 30 listed Italian firms in market capitalisation in 2000. It was controlled, through a pyramidal structure, by the Tanzi family; the family controlled 50.02 per cent of the voting share capital in Parmalat Finanzaria, which in turn controlled the rest of the companies in the Parmalat empire (Melis 2005: 480–81). The accounting scandal that brought it down in 2003 was, much like the Enron scandal in the United States, a massive case of false accounting: prosecutors estimated that about €13 billion disappeared in the company's accounts (Delaney 2004). Much of the critical discussion generated by the Parmalat case focused on the fact that the strong Italian laws regulating corporate governance are weakly enforced, both by public actors (Ferrarini 2005) and by private economic actors through the courts (Ferrarini and Giudici 2005). The problem of enforcement against powerful controlling shareholders like the Tanzi family is not restricted to the Parmalat case. Enriques (2003), for example, provides evidence suggesting that Milanese judges have been generally loath to rule against controlling shareholders.

In the wake of the high-profile scandals at Parmalat and at Cirio, another large food company that went bankrupt in 2002, there was significant criticism of banks closely tied to the firms (notably Capitalia) as well as of the regulatory oversight of CONSOB and the Bank of Italy (Edmondson 2004; Israely 2004). Yet the reform of Italian company law enacted in 2004 did little to change any of the oversight failures raised in the Parmalat case, as it had mainly been designed before the discovery of extensive fraud at Parmalat. Its principal innovation was to allow companies to choose one of three sorts of board structure: the traditional Italian model, with a board of statutory auditors; a British-style board, with an independent audit committee; and a German dual board (Melis 2006: 62–3; Ventoruzzo 2004). This change in law has had little effect as of this writing, with almost no companies choosing alternative board formats: 'Only one company has adopted the unitary [British-style] board structure, while two have adopted a two-tier board structure with a supervisory council' (Melis 2006: 63). The broader lesson of the Parmalat scandal is not that Italian laws protecting minority shareholders fail to conform to international best practice; in the main, they do. The lesson instead is that controlling shareholders maintain many resources they can use to keep laws on the books from compromising their effective control of companies, particularly when the enforcement capacities of public and private actors remain weak (Ferrarini 2005).

The second major Italian scandal of recent years may have a greater impact on the banking system than did the first. Antonio Fazio, the long-serving head of the Bank of Italy, was compelled to resign his post in

December 2005, in the wake of evidence that he had used his office improperly to favour the bid of one Italian bank to buy another over the bid of a Dutch bank, ABN Amro. Simultaneously with his resignation, the government passed a law eliminating lifetime tenure for the head of the Bank of Italy and diverting some its regulatory authority to CONSOB, the market regulator (Barber 2006). Fazio's replacement, Mario Draghi, had led the drafting of the Draghi laws. Cioffi and Höpner (2006: 475) argue that the very fact that Mario Draghi himself replaced Antonio Fazio 'reveals a pro-shareholder shift in power' that may have further, significant consequences on the shape of Italian capitalism. Once in office, Draghi quickly eliminated the capacity of the Bank to exercise vetoes over proposed takeovers, which had allowed Fazio and the Bank a significant amount of influence on the course of merger activity (Michaels 2006). There was also a series of bank mergers in 2006, including those between Italian and foreign banks, indicating that the Draghi regime is more inclined to follow market logic than was its predecessor (Barber 2006; Renaissance 2006).

For Italian banks, clearly, 2006 was a year of important organisational change. However, it is a large step from there to the breakdown of the patient capital at the heart of the Italian model of capitalism. It is important to recall that Italian banks rarely hold important direct controlling interests in the ownership of non-financial companies (Melis 2006: 45). Because banks have such a small ownership stake, there is little reason to think that consolidation of the banking sector will have an impact on broader ownership patterns. In Germany, where banks have historically played a much more important and active role in patient ownership, significant change in the financial sector has gone hand in hand with the stability of the system of ownership of non-financial companies there (Culpepper 2005). There is currently no evidence to suggest that Draghi II will have any more effect on patient capital than did Draghi I, nor is there a plausible causal mechanism that would link the change of strategy of the Bank of Italy with wider changes in Italian ownership structure.

Italian Stability and its Implications for Comparative Political Economy

The headline finding of this article – that patient capital in Italy has been remarkably stable over the past decade of turbulent political change – is consistent with the findings of other scholars who have looked closely at the Italian case. Della Sala's (2004) survey of the political economy concludes that, despite the growth of equity markets and private shareholding, the Italian model of concentrated control remains unchanged. Deeg's study (2005: 543), which emphasises the sweeping nature of the *policy reforms* undertaken, concludes on an appropriately circumspect note: '[I]n Italy actual practice deviates considerably from the new corporate governance rules and state capacity and willingness to enforce them is uneven. In this sense change in corporate governance reflects a broader and traditional pattern in Italian politics and policy making.' Legal scholars familiar with the Italian case have manifested a similar scepticism as to the real effects of legal changes in corporate governance and company law in the absence of effective public and private enforcement capacity (Enriques 2003; Ventoruzzo 2004; Ferrarini 2005). The practice of Italian concentrated shareholding is alive and well, and this fact is uncontested.

Yet the stability of the Italian system of patient capital is deeply problematic for current theories in comparative political economy that would treat Italy as a confirming case for their analyses. The problem here is not so much in the political analysis of partisan preferences as in the connection between formal legal changes and changes in actual practice. The partisan analysis of Cioffi and Höpner (2006), showing the left-leaning party bias against patient capital, appears to be correct. The left-wing coalition government elected in 1996 adopted legislation to dismantle patient capital, which they viewed as a construction of the political right. This is an important corrective to other work, notably by Roe (2003), which assumes that parties on the left instinctively favour structures of concentrated capital. Privatisation is a powerful weapon, and the political use of privatisation did have some effect on lowering the average concentration of capital in Italy (Bianchi and Enriques 2001; Deeg 2005).

The evidence on the role of transparency coalitions, proposed by both Deeg (2005) and Gourevitch and Shinn (2005) is more ambiguous. After the strategic change of direction by the largest Italian union in 1992 to work more closely with the government, Deeg argues that unions were generally supportive of corporate governance reform. There is little direct evidence showing any point in the legislative process where union intervention (as part of a transparency coalition) led to the passage of a law that would not otherwise have passed. Cioffi and Höpner (2006: 501–2, n. 99) claim there is definitive comparative evidence that parties, not the transparency coalition, explain change: '[T]he "transparency coalition" . . . does not explain cross-national governance reform. Even where labour supported corporate governance reform, as in the United States and Germany, it was not a driving force for change.' Whether or not the Italian reforms could have been passed without the tacit support of labour remains a speculative question. Yet it seems on the basis of this evidence that the labour component of the transparency coalition is a permissive factor, rather than a causally central one.

If our only concern is legislation, then the theoretical expectations generated by these political scientists fare well. Yet political scientists do not care about law for law's sake. We only care about it if the passage of laws is able to generate real social change. The evidence on this point is compelling and negative. Left-wing control of government for a long stretch, even one that included the (non-repeatable) chance to privatise much of the state-owned portion of the economy, failed to have any effect on that portion of the economy that was not state-owned. Italy was in 1995, and remains in

2007, a system in which a small number of shareholders continues to exercise control over most of the companies listed on the stock exchange. Or, as a title of a recent working paper puts it, Italy is a place where 'controlling shareholders "live like kings"' (Meoli *et al.* 2006).

In this respect, political scientists face a serious question: who cares? If our dependent variable is policy, but policy change has no real effect on the institutions that structure authoritative decisions about resource allocation in the political economy – such as how firms are actually run – then what is the interest in studying that? If political scientists want to develop theories that respond to substantive issues about the structure of the political economy, then the Italian experiment in finance and corporate governance is an important case for evaluating the state of theory in comparative political economy. Sweeping legal change, coalitional change, and electoral system reform – all of which are variables put forward by scholars to explain change in the political economy – made no difference to the stability of patient capital in the Italian case. Why might this be so? If the system is robustly resistant to all the variables we think are important, perhaps we need to shift our attention to factors that can explain this stability.

The political approaches discussed so far assume that the authoritative decisions about the rules of the game in finance and corporate governance are made in the legislature and imposed on economic players, which is why they so heavily emphasise electoral rules or the partisan composition of government.[10] The results in Italy suggest this is looking at the issue through the wrong end of the telescope. Instead of focusing on the resources of the coalition favouring change, we should pay closer attention to the perceptions of those who favour institutional stasis, and the ways in which they can defend their preferred institutional regime. That is, first, what are their interests, and how are they defined? Second, holding their perceptions constant, we should also try to understand the resources they can deploy to defend those perceived interests.

What could change the perceptions of these institutional incumbents about the value of the current system to them? The first question is basically one of costs and benefits, so long as companies have individual controlling shareholders. Many blockholders in Italy prefer the system the way it is, as they derive important benefits from it. Pyramidal ownership structures allow large blockholders to leverage their stakes into significant controlling interests in a variety of companies (Bianchi *et al.* 2001). Company managers are responsive to their large shareholders, and indeed CEO turnover in Italy is more closely tied to ownership changes than to actual performance (Melis 2006: 45). Moreover, the continued strength of family firms in Italian capitalism, even in very large corporations, may create additional non-pecuniary (legacy-related) reasons that encourage large shareholders to defend their stakes (Pagano and Trento 2002). Unlike in France or in Japan, there is not currently a large problem of coordination among Italian controlling shareholders. Thus, the particular structure of Italian capitalism may prove more robust than that of France, which changed quickly in the late 1990s, as managers and large shareholders carried on a public debate about their shared perception of the future of large shareholdings (Culpepper 2005). In Italy, there is little problem of coordination, and so the ability of a central player to destabilise the network by defecting from it, as happened in France, is considerably reduced.[11]

The evidence from Italy demonstrates clearly that a legislative majority that is hostile to patient capital is insufficient to trigger institutional change. Yet we need to know much more than current research tells us about the ways in which large shareholders exercise political influence. Political scientists have generally been slow to study the lobbying strategies of large companies, and particularly so for Italy – exceptions to this rule include Hart (2004) and Martin (2000), but those contributions do not deal with Italy. Managers of large companies, it bears repeating, work at the behest of their large shareholders. These companies have direct lobbying strategies as well as collective lobbying through their associations, such as Confindustria. The Italian case of corporate governance and finance is puzzling in part because the political winners – the left, liberalising bureaucrats sympathetic to them, and the members of the transparency coalition – got the reforms, but not the outcomes, they wanted. How did companies with concentrated ownership respond to this political onslaught? This is not something about which we have much information, in part because our reigning theories assume that controlling government means you win on the details of legislation and regulation; this logical leap is probably flawed. If we reinterpret the relevant question for Italian corporate governance from, 'What was the governing coalition?' to 'What are the political resources of the blockholders?' we are then much more likely to start asking the right empirical questions about the process of change.

Beyond intervention in the regulatory process, we should also pay attention to other market actors who oppose the influence of large shareholders in Italy. Gourevitch and Shinn (2005) expect institutional investors, especially Anglo-American institutional investors, to work as active players in the corporate governance debate within a given country. The way incumbents stack the domestic deck has much to do with the sort of institutional investors that become active, and how they in turn affect the domestic structures that support patient capital. Michel Goyer (2006), for example, has shown that Anglo-American hedge and mutual funds – the most impatient of capitalists – were far more attracted to French than to German firms, because of the way those firms structured authority internally. The preferences of these funds cemented the breakdown of French patient capital while leaving German capitalism unaffected. Bianchi and Enriques (2001) have gathered evidence showing that most of the institutional investors active in Italy are tied to Italian banks and insurance firms, which face potential conflicts of interest when trying to play the role of activist investor in companies.[12] This does not exclude their playing a heightened role in corporate governance, but the analysis of Bianchi and Enriques (2001) shows that the vast majority of their holdings are below the 10 per cent ownership threshold, making it difficult for them to use special shareholders' meetings as an effective mechanism for developing activist governance. At least as of this writing, institutional investors do not seem likely to be a source of radical change in the Italian system of patient capital. If they do play this role, though, it seems more likely that the change would come through their power in individual companies in which they had ownership stakes – as Goyer's work (2006) shows for France – rather than through their political lobbying as part of a transparency coalition (cf. Gourevitch and Shinn 2005).

Each of the areas I have peremptorily sketched in this section represents a potential vector of change for the system of Italian finance and corporate governance. Each concerns the balance of power and ways of thinking about common interests among a set of actors with potentially shared interests. Yet none is well conceptualised in current theories of corporate governance developed by political scientists, because none takes place in a legislature or regulatory agency. The parsimonious explanations that associate interest conflicts with certain social coalitions or partisan composition of governments ignore the variety of informal strategies available to blockholders to maintain their preferred regime. Lawmakers can raise the costs to large blockholders of retaining their controlling shares in companies, but as the proliferation of shareholder pacts between 1998 and 2004 suggests, blockholders can organise in response to such efforts (Melis 2006: 49). In thinking about these strategies, I have proposed three categories political science might use to organise future research: collective interest definition of blockholders; collective interest representation and lobbying strategies; and firm-level analysis of potential competition to blockholders' resources. We lack definitive information about any of these areas. Yet the scarce information about the first and the third, especially considered in comparative perspective, suggests that the Italian blockholders are more likely than not to maintain their sway within the system of Italian capitalism. Until we improve our information about the exercise of power and influence through these non-legal channels, we will retain a very partial understanding of the real political dynamics of Italian corporate governance and finance.

Conclusion

Social science moves forward when the complex data the world gives us allows us to see clearly the achievements and failings of current theory. The Italian experience between 1996 and 2001 of a leftist government, which enacted sweeping regulatory reform of corporate governance and an ambitious privatisation programme aimed at dismantling the Italian model of concentrated shareholding, offers blindingly clear results. Parties of the left do indeed pursue legal programmes inimical to patient capital, at least where patient capital is perceived as a political construction of the right, as in Italy and Germany. On this point about the political preferences of the left, Cioffi and Höpner (2006) are correct.

The most important result of the Italian experience, though, is not that the left passed a series of measures aimed at breaking down the Italian system of patient capital. *The most important result is that the effort failed.* Despite the state's ability to privatise large chunks of the economy, government moves to break down patient capital had no effect on the concentration of ownership in the private sector. Government policymakers shot their entire quiver of arrows at the Italian model of capitalism, and all that emerged was an Italian model where concentrated and family ownership remained, while state ownership faded (Pagano and Trento 2002). It is implausible in the wake of these facts for political scientists to argue that formal legal reform is the sole driver of institutional change in coordinated financial systems.

These results leave us with a puzzle: why was the Italian structure of finance and corporate governance so unaffected by these legal changes? I have suggested that we will make progress on this question only when we turn away from the formal composition of governments and coalitions, and look instead at the political challenges and resources of incumbents. How do large stakeholders and the managers they support coordinate their political action? What are the strategies of organised employers in such systems? And what does the political terrain look like at the level of the firm, which is often where real change happens in highly structured political economies (Culpepper 2005; Goyer 2006)? In order for political scientists to continue to contribute to debates about corporate governance and finance, we have to turn our analytical attention to problems of coordination and conflict within companies and to the ways in which companies coordinate their strategies. The questions I have posed in this article suggest the set of issues that may animate research on this new political frontier. Those who work on corporate governance and politics in Italy have had the good fortune to find an unambiguous disconfirmation of existing theory. It is time to go back and get more data.

Notes

1. Systems of finance refer to the primary ways in which companies acquire capital (e.g. through equity markets or banks). Corporate governance refers to the set of rules that determine the ability of shareholders to exert control over management. The two concepts are, as a political construction, closely intertwined.
2. Vivien Schmidt (2002: 141), a prominent defender of state capitalism as a distinct analytical ideal type, demonstrates the unease of political scientists when tasked with assigning Italy to a category: '[Classifying] Italy is a harder call, since it may very well have moved from failed state capitalism toward competitive managed capitalism.'
3. For real-world examples of the intricate pyramidal links maintained by large companies in Italy, see Bianchi *et al.* (2001) and Melis (2005).

4. LLSV developed an index of minority shareholder protection, and they showed that countries based on French civil law had much lower shareholder protection and higher ownership concentration than those countries with other legal systems (La Porta *et al.* 1998; 1999).
5. Roe uses 'social democracy' as an inexact shorthand for countries in which 'employee pressures are strong . . . Those nations in which the pressure on the firm for low-risk expansion is high, the pressure to avoid risky organizational change is substantial, and the tools that would induce managers to work in favour of invested capital – such as high incentive compensation, hostile takeovers, transparent accounting, and acculturation to shareholder-wealth maximization norms – is weak' (Roe 2003: 24).

   Political scientists have demonstrated that Roe's conflation of social democracy with the more general political context favouring employee protection is empirically inaccurate (Gourevitch and Shinn 2005). Roe's argument, though, is about a particular way in which capitalist polities constrain market forces, and his reduction of those forces to 'social democracy' actually does a disservice to the importance of his more general argument.
6. This is consistent with the broader set of neo-liberal ideas that united civil servants in these two influential state institutions during the 1990s (Quaglia 2005).
7. The law was named after Mario Draghi, at that time the Director General of the Treasury, who led the commission that drafted the law. The discussion of the Draghi Law in this paragraph draws on Deeg (2005), Melis (2006), and Bianchi and Enriques (2001).
8. The main corporate governance issue not addressed in the Draghi Law – the structure and pay of company boards of directors – was addressed through a voluntary code, the Preda Code, which was issued in 1999 and revised in 2002 (Melis 2006: 55–62).
9. Ownership concentration is not a perfect metric of patient capital only because some countries have developed patterns of stable shareholding that do not depend on concentrated shareholdings, but rather on networks of cross-shareholding (Japan) or special takeover defences that empower management to block a hostile takeover (Netherlands) (Gourevitch and Shinn 2005). In these cases, patient capital may exist in the absence of ownership concentration. In the Italian case, though, patient capital has traditionally been exercised through highly concentrated ownership (cf. Pagano and Trento 2002).
10. This problem is not limited to political scientists, although they have been particularly prone to emphasise the role of partisanship and coalitions in legal change. In a piece published in the *American Economic Review*, for example, Pagano and Volpin (2005) have modelled the politics of change in the economy by equating changes in legal protections for minority investors (as in the Draghi law) with the real protection of minority investors. Similarly, the very existence of the LLSV index of minority shareholder protection assumes that coding laws give a reliable cross-national measure of the degree of minority shareholder protection (La Porta *et al.* 1999).
11. Yet as the institution of the shareholder pact increases in importance (Melis 2006), this issue has the potential to acquire a coordinative aspect, because this becomes a question about how several actors perceive both the value of an existing institution, and how they think the other major shareholders also value it (cf. Culpepper 2005).
12. The problem of conflict of interest, they claim, stems from the fact that banks offer multiple services, and so may avoid using their mutual fund role to exercise strong oversight over owned companies to avoid alienating those companies who are also their clients. Though product market competition could attenuate these effects, they argue that there is very low product market competition in this area among Italian financial companies (Bianchi and Enriques 2001: 23–4).

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