Market, Cultural Heritage and the Solution to the Corporate Governance Problems

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Abstract

The current economic scenario and the cultural heritage are two very important factors that heavily affect the companies and the way in which they can resolve the corporate governance problems. According to this principle, we intend making an analysis on the endogenous and the exogenous factors affecting the company and its structure. For example, in Italy the difficult situation on the market - straightly connected with the international financial and economic crisis - involved relevant changes concerning the number of firms, their structure and their own management. But it is not the single reason causing the companies metamorphosis. The cultural heritage played - and still today it plays - an important role for the company growth and dimension. The analysis is divided in two parts. First part: comprehension of the exogenous factors indirectly affecting the company and their structure. As we will see, the corporate governance is connected with different factors and it straightly depends from them. In this part we will analyze Market, Technology and Tax burden. Above all, the cultural heritage is one of the most important factors, then it will be analyzed in depth. Second part: analysis on the endogenous factors that directly affect the corporate governance. Stakeholders’ importance for the company development and performance will be deeply considered. More in particular, in this part we propose to analyze the way in which Stakeholders affect the company management – then consequently its performance - and above all the relationship between small company-Stakeholders and large company-Stakeholders. Conclusions: This study, therefore, proposes to make an analysis of the reality which today characterizes the companies, the factors that are affecting it and the new challenges for the Corporate Governance in Italy.

Keywords: Corporate Governance, Entrepreneurship, SMEs, Management, Stakeholder

1 – Analysis on company development in Italy

1.1 - The exogenous factors affecting the corporate governance

Generally, every analysis and study focused on the corporate governance has a direct approach to the relations and the systems by which a company is directed and controlled.

That’s possible when the analysis considers only the internal situation and the different parts that have a precise role in the company management.

Instead, in this case our purpose is creating a sort of link about the company and two different typologies of factors that have a great importance for its development. We are talking about the endogenous and the exogenous factors.

It’s hard to think that a company and its governance are only affected by the relation among the managers and the shareholders.

Making a precise and depth analysis about the company metamorphosis during the years, we can see how much do the external conditions (exogenous factors) are important for the managers’ businesslike choices and the shareholders’ choices when they adopted a particular managerial structure.

Undoubtedly, these factors indirectly affect the corporate governance but directly the company strategy.

Taking into consideration the current global economic situation, we can clearly understand that the market has affected the number of the born companies and the death companies. (Istat, Noi Italia 2014, p.63)
Indeed, the corporate strategies and the managerial arrangement widely depends from the market request and by the consumption.

Let’s make an example.

As revealed by the Eurostat data (tab.1), in the last two years the families savings are increased.

In this sense the French families and the German families have the most high level of propensity to save.

The values of the Italian families propensity have decreased in comparison with the others but always remaining upper than the Spain families level.

More in particular the crisis strongly beat the Italian family consumption with enormous consequences on the companies production and structure. (tab.2)

From the 2008, the immediate reactions to the crisis and the family savings were:

1) defending own placement on the market (medium and small enterprises, 64 % / large enterprises, 69 %)
2) entering new markets (small and medium enterprises)
3) product diversification (large enterprises)
4) increase of agreements between companies.

In the case mentioned at the point n. 4) the large corporations generally choose particular form of agreements as the Joint Ventures or the Consortium, while the small and medium enterprises adopt informal agreements. (Istat, “Annual report 2013”, p.68)

This is just an example - widely known by the economists - showing how does a exogenous factor affect the company.

The market variability pushes company to make different production or service strategies and as direct consequence company will adopt a different organizational strategy.

1.2 - Know-how and less tax burden as essential conditions for company development

Usually, when we talk about the start-up phase of a business or about an underway business in Italy we are considering different situations for entrepreneurship.

In the case of a family businesses, we must consider how does the family tradition is important for the entrepreneur; generally, this principle is valid if the firm is already started and the sphere of people revolving around consists in family members.

In the case of a sole traders, we have to consider how do the aspiration and the prospect of earnings such as the possibility to be not a dependent worker are important for him.

The interest in realizing an innovative idea has not to be overlooked. This motivation, which in Italy is very little considered by banks rather than in America, it is an attitude widely considered by sole traders, by family firms but also by large enterprises.

If the original motivations underpinning entrepreneurial choices are generally related to the individual sphere or to economic and social reality in which the individual or the group of individuals are living, the difficulties suffered by companies are shared at a general level. Let's make some examples:

1) amongst the major problems that start-up or underway companies meet, there is the difficulty of doing organizational-administrative choices. Bank indebtedness is today a practice widely observed by businesses and entrepreneurs. In fact, today, they cannot work easily without it.

As argued previously, the possibility for a start-up to get a help through seed capital or venture capital is very difficult. However, it is strictly necessary in order to emerge on the market. Also the difficulty to find banking funds has become one of the main challenges for Italian companies. The entrepreneur has never been so close to the primordial figure of entrepreneur described by Cantillon.

The risk has never touched so high levels; in absence of external aid, whether public or private, companies and entrepreneurs have primarily to face the investment with their own funds.

The crisis has prompted a new rule: the credit is awarded, but only if the enterprise holds a satisfactory guarantee fund for what has been lent by banks.

In short, money is granted only to those who have already it and not to those who need it most.

2) together with these daily difficulties, it's also detected the burden of taxes that lie on the corporate governance, such as: IRES ("Corporate income tax" amounting to 27.50% in 2012), IRAP ("Local tax on productive activities" amounting to 3.90% - this is a perverse tax also applied to companies at a loss), IRPEF ("Personal income tax", progressive from 23% to 43%) which added to other local taxes reach a taxation higher than 44% on the income produced by companies.

3) labor costs in Italy - it means not only the remuneration of employees but also the burden of contribution connected to it. This cost is amongst the highest in Europe and in the world.

4) another difficulty heavily encountered by companies is the ability to find and to employ qualified personnel, because most often young people look for and find a job abroad.

The economic growth accomplished in recent years has prompted more companies to use specialized technical skills and advanced technology.

In recent years Knowledge Capitalism seems to have become one of the frontiers of companies operating in a globalized system.
5) another considerable difficulty is the relationship between company and its customers. In this sense the crisis weighted very much on this delicate relationship. The customer loyalty regarding firms is less than before due to higher level of competition on the market. Furthermore, the destitute customers increasingly push the company into insolvency in relation to suppliers and creditors.

This vicious circle has enormously contributed to break the relationship between Bank and enterprise. However, it cannot be regarded as pure architect of the changed financial policy of banks (increasingly inclined to make financial investments rather than to invest on business and in favor of the same).

1.3 - The importance of cultural heritage

When we approach the corporate world, we must always take in consideration that the firms are the result and the direct expression of endless changes that have characterized the State in which they work. The historical context, legal provisions but also and above all the cultural settings are important factors which have influenced - and still today they widely influence - the firm development and the management by which the governance is composed.

It is enough thinking to A. D. Chandler’s studies, who succeeded, with admirable skill, to prove that starting from the early 1900 Nations such as the United States, Britain and Germany were promoters of a very diversified firm development to study its causes. (Chandler A.D., 1994)

In the United States the powerful organizational development process within companies made increasingly the need for a strong managerial structure that would have pushed the birth of Competitive Managerial Capitalism. Obviously, we should not forget the exogenous conditions such as rich and growing domestic market, the wide availability of new technologies and a legal framework that limited contractual agreements on prices and on the market. The direct result was the large corporations in the field of energy, chemistry and transport, marked by a complex internal organization and a widely diversified corporate structure.

This setting would forever dictated the structural rules and the governance of the large transnational corporations.

Germany was perhaps the nation which has more features in common with the managerial U.S. corporations. The explosion of a massive managerial setting characterized by the interplay between first movers and senior managers gave the opportunity to leverage the entrepreneurial skills in the various sectors of production, management and marketing. However, we must take in consideration how German corporations have always kept alive and strong the family sense and the degree of interaction between management and first movers.

We have not to forget the fact that the degree of diversification and collaboration between the German companies has always been significantly higher than the footprint of the competitive USA corporations, so much to be defined Managerial Cooperative Capitalism. One reason for this may be found in the fact that in Germany there were no specific antitrust laws such as in U.S. (Sherman Antitrust Act, 1890).

In Great Britain, on the contrary, companies were marked by a completely different evolutionary process. Although the fields of activity were the same in which large enterprises USA developed, UK companies were personally managed (Chandler, 1994: 387) or the management remained within the personal or family context.

Chandler, in fact, stresses that internal corporate organizations were generally characterized as follows:

- **Personal Enterprise**
- **Entrepreneurial or Family Enterprise**: holding of shares by the heirs of the enterprise founders
- **Managerial Enterprise**: where there is actually a managerial governance which, however, remains structurally limited and always under the influence of the founders or the heirs.

Although with notable differences and peculiarities that distinguish companies in each State, we can, however, support the theory that there is a common denominator amongst the family structure of Italian companies and British personally managed companies analyzed by Chandler.

Even in Italy, as well as in the United States or in other Western countries, corporate governance has been heavily influenced in many ways by historical circumstances, regulations and market conditions.

For instance, we can consider the importance of the access to resources and to technologies had as well as the ability to have large capital to start up (today called *seed capital*) for the large American firms.

In Italy, proved by war and financially collapsed, there was no viable alternative to the development of simple family industry.

Doing just a premise of historical-economic character, we see the way in which the major manifestations of the large corporate groups in Italy were the State-owned enterprises. In this sense, the IRI (Istituto per la Ricostruzione Industriale) was primarily established for the purpose of acquiring the shares that the banking system held in important private companies (as well as afterwards prescribed an act of 1936) and with the intent to rehabilitate distressed corporations.

Amongst the best expressions we also emphasize ENI (Ente Nazionale Idrocarburi 1953), EGAM
(Ente Gestione Attività Minerarie 1971) and EFIM (Ente per il Finanziamento Industria Meccanica 1962) that in the period from 1950 to 1980 were the highest expressions of State intervention on the market in order to create infrastructure and basic industries. (Amatori F., 1996)

The setting of large State-owned Holding Company, however, did not withstand to changing times increasingly directed to a fluid market, competitive and especially international, particularly in the economic crisis that swept Italy in the various productive sectors such as steel and that one of the facilities.

In the early 1990’s the large State-owned corporate groups reached a degree of diversification that it was unable to withstand the market challenges. The result was a gigantic process of privatization.

With the law of the 8th August 1992, No. 359 IRI, ENI, INA and ENEL were forced to put their shares into the hands of the Treasury Ministry transforming themselves in Joint Stock companies.

Therefore, the various industrial branches in which the presence of the Public Institution was massive (food industry, infrastructure, telecommunications and steel) were converted to private enterprise.

From this historical-economic premise, it isn't so difficult to understand because it was impossible for a country such as Italy to develop a process of competitive or cooperative management comparable to that one arose in the USA or in Germany.

If on the one side the public mark was able to resettle a stagnant economy by implementing a plan for building a new industrial base, on the other side it failed to form and to establish gradually a class of officials/manager - separated from the political leadership - which could find valid and ready managerial solutions for the holding companies.

The decision to adopt a managerial system that could handle an equally complex organization was the result of a massive fractional property.

The innumerable amount of shareholders pushed the corporations to delegate managers the effective administration. However, this process has prompted administrators to take over more and more power, sometimes without getting effective results to the shareholders.

Adolf Berle and Gardiner Means studied in depth the question concerning the separation between control and ownership.

The interest to find a solution that could justify the managers decisions pushed Berle and Means to analyze thoroughly modern companies and everything is straightly related.

First and foremost, we believe that we should take into account the first and fundamental clue thanks to which the two authors were able to carry out the subsequent considerations; we are referring to the transformation of large company into the so called "semi-public company". (A.A. Berle and Means G.C., 1966: 6)

The last two decades of the 1900 were in fact deeply marked by a dynamic and continuous process of mergers and incorporations that would have so greatly influenced the organizational style within the enterprise.

New organizational structures had a large number of workers employed under a single management as well as enormous riches coming from different individuals were placed under a single control.

The immediate consequence was the formation of corporations - made and supported by a plethora of shareholders - submitted to the control of few managers.

This decisive process - begun due to the semi-public company born - according to Berle and Means pushed towards a split of the corporate control.

The proof of this theory lies in the fact that the new Corporation allowed several possible combinations of shareholders.

Always according to Berle and Means, this possible scenario would have been induced following two distinct processes occurred in the last century: the massive ownership diversification, leading to a disproportionate number enlargement compared with the detention and the real control management; and finally an enterprise enlargement that have increasingly felt the need of a strong and steady managerial control.

The enlargement of the so called “semi-public companies” composed of a vast number of shareholders, created in fact countless methods and solutions for the corporate control and changed the classical setting that for centuries had marked the relationship between ownership and corporate governance. (tab.3)

2 - The endogenous factors directly affecting the Corporate Governance

2.1 - Introduction to the endogenous factors through the Berle and Means’ though

If factors such as the market situation, the national legislation or the historical heritage indirectly affect corporate governance, other factors definable "endogenous" massively characterize it from the inside. As A. Berle and G. Means showed in the book "The modern corporation and private property" [1932], the company has undergone far-reaching changes in the management structure due to disproportionate growth of the shareholder's number. (semi-public companies)
Thanks to the Berle and Means’ studies it has been possible understanding how does few fractioned shareholders group is important for the corporate governance. Consequently, their theory highlighted why a wide and fractioned shareholders group started to delegate the managers.

2.2 - The relation “Company-Stakeholders”: one of the most important endogenous factors

As we have considered before, the size of the Italian company has specific parameters that for some reasons mark it from those of other European countries. The cultural and historical heritage has highlighted a significant singularity about entrepreneurship and the structure which has set, with everything that goes with it.

We're not talking just about managerial techniques but also about the typology of Stakeholders who gravitate around the company and who influence it significantly.

This category of entities - sort with R.E. Freeman (1984) and implemented with new figures like partners, the media, the debt holders and creditors, policymakers and even competitors by Friedman (2006) - plays an important role in the corporate governance, in the case of a collective enterprise or in the familiar one.

Therefore, also the typology of Stakeholders will vary in base of composition and size of the enterprise.

It can be easily understandable just thinking to the relationship between a large enterprise to its business partners or shareholders compared with a family company with medium size.

The relationship between enterprise and suppliers, in the specific case, is the best example that can express how the category of stakeholders is important in the life of an enterprise.

Coase's theory (1937) can reinforce what we said before; in fact, through the Transaction costs theory, he was able to express the capacity of the firm to avoid additional costs in the production processes. This theory can be applied to the large companies but not certainly to the SMEs which can hardly surpass or “internalize” the production steps, avoiding to sign contracts with any suppliers.

It will be also understandably different the degree of interaction that occurs between a large company and financiers-creditors (such as banks) and that one created in the case of SMEs.

In the specific case of the relationship between Banking system and enterprise, there are a few considerations to make.

The intervention of bank credit for the family business performance (or in the case of SMEs) will play a really different role in comparison with the specific case of a wide company structure.

The access to finance for SMEs is now considered as a component sine qua non the company can adapt itself to the market changes.

Indeed, Italian companies have enormously suffered from the financial system crisis started in 2007 and persisting until today. (tab.4)

The banking support to enterprises has fell and enterprises insolvency on the previously bestowed credits has widely increased. (tab.5)

To overcome situations of collapse and suffering, many enterprises have significantly diversified their corporate choices, sometimes recommended by their "Financial Partners".

This is the case of Risk Management and business investments in derivatives products.

The mirage of risk management that was sponsored by banking system through the techniques of risk identification, measurement, and control correlated to the corporate performance have led many companies to diversify their investments in derivatives products. All this, even and especially for diverting from an unfavorable economic situation.

It is undeniable the fact that the growth in the use of derivatives is constant even in the case of SMEs (general or limited partnerships) and sole traders.

For many years corporate organization has shaped and based on leverage programs.

Perhaps, given to the disastrous effects that the unsuspecting massive use of these instruments has meant in recent years, not only in the business world but also in the same banking system, it seems advisable to re-dimension the relationship persisting between enterprises and banks finding an optimal solution. Here, we're talking about a solution that allows companies to transform their stakeholders in collaborative and non-invasive entities. In brief, a bold plan to deleverage. However, we note that if it is desirable to reduce the enterprises dependency from the banking world, in a period like the current an exasperated deleveraging action in the "PIGS" countries can result in deleterious effects sometimes leading to a debt deflation (generalized price drop) (Bortolotti B.,2013: 169)

In short, following a Latin maxim ever fallen into disuse: "in medio stat virtus" (Horace).

With the introduction of new production systems on the market, it was big - and still today it is - the need to invest in research and development. But, how it can be carried out, if the banking system in Italy is unwilling to finance projects of technological innovation and these latter are primarily accomplished through the use of set aside profits reserves.

Only financial indebtedness seemed to be the escape for the enterprises survival.
Banks and financing companies have become absolute and irreplaceable partners of the Italian firms.

In order to overcome the need for a financial support in times of crisis such as today - in which banks are disinclined to lavish credit – then, the insertion of the venture capital practice could be one of the many great ideas.

The possibility to use venture capital funds combined with a public participation in risk might be in the future one of the solutions against general insolvency status of small and medium enterprises.

3 – Conclusions

Through an examination of the main characteristics held by Italian SMEs, it has been possible to bring out the countless differences that distinguish them from others European companies and USA ones.

As it has been shown in the previous paragraphs, the historic and economic roots played a decisive role in the entrepreneurship development in Italy. The particular economic, historical, sociological but also legal and financial aspects have marked the enterprise development in Italy until the current days. However, the current managerial arrangements, in Italy such as in each other Country, cannot be closed off from different factors existing inside and outside the company.

The governance structure will be the result of the interaction between the endogenous factors with the exogenous factors.

Moreover, it is clear how much do the managers have to analyze both the category of factors in order to make the best possible choice.

On the basis of what we have upper mentioned, we would like to highlight that the analysis on the corporate governance should take in consideration even more the interdisciplinary research.

Indeed, it’s not possible studying the corporate governance theme without an accessory historical, legal, political and sociological research that inevitably affects the environment in which the company works.

References

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**TAB. 1 - FAMILY PROPENSITY TO SAVE IN THE MAIN EUROPEAN ECONOMIES - 2000/2012**

![Graph of Family Propensity to Save](image_url)

Source: Eurostat data in “Istat, Annual report 2013”, p.9
TAB. 2 - ITALIAN FAMILY PROPENSITY TO SAVE - 2008/2012

Source: Istat, “Annual report 2013”, p.8

TAB. 3 - SHAREHOLDERS TYPOLOGY AND GOVERNANCE

Source: author’s elaboration on the basis of Berle and Means’ studies.
Tab. 4 - Bank Loan to Italian Residents


Tab. 5 - Bank Credit to Italian residents by economic activity - in millions euro