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The Public Company in European Integration

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THE PUBLIC COMPANY IN EUROPEAN INTEGRATION

(Gustavo Visentini)*

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In periods of fast-moving change it is useful to reconsider the fundamental principles of legal institutions. These principles are the concepts from which the law is developed. They come from tradition and experience, we can identify them through history and through a comparative approach. These principles are the necessary starting point, whilst following the evolution of the law, in order to understand and decide on any reforms.

For the legislator the principles are the policy reasons behind the reform, entrusted to the interpreter (the Court) for the application of the law (*ratio legis*). Academia examines and discusses the principles to assist in the drafting of the law and to maintain its quality. It is from such a perspective that I will examine and discuss the principles of the public company.

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This paper is a follow-up to the company law research project that resulted in the publication of Arthur R. PINTO and Gustavo VISENTINI, *The Legal basis of corporate governance in publicly held corporations – A comparative approach*, Kluwer International, London 1998, and intends to be the basis and guideline for a new research project.

I

The differing company models in national legal systems

1. Two models.

The company is an institution that the law has adapted in order to fulfil the specific functions it has been called on to carry out in different situations. Company principles can be grouped into two models: a) the company as a device for the collection of savings from the public in order to finance investments; b) the company as a device for the organisation of large businesses.

The first model reflects the real purpose of the company and has seen a noticeable development in the USA. The second model is the product of the characteristics of early industrialisation in the Germanic countries, widely used in post-war European economies. I will examine this second model from the Italian perspective.

This analysis proves necessary as the integration of European economies, as well as competition with the USA, have led to major changes in company law. Indeed there is a tendency towards a predominant model, which leaves behind national characteristics and addresses problems which are increasingly common.

Changes affect the national conception of the company, its use, its ownership structure and they are reflected in the *corporate governance*. That is why changes cause social and political tensions. The alleged neutrality of the company as a legal device (*i.e.* the idea that a company can be used for different purposes, both profit or non-profit) is merely a superficial façade that some authors put forward in the Sixties.

2. The structure of the financial system shapes the company model.

Which of the two models prevails depends upon the structure of the financial system.

If the system regulates the financing of businesses through the intermediation of banks and with the investment of major shareholders (and in

some instances state funds), without obliging to resort to the securities market, the purpose of the company (to collect diffuse savings) withers and the institution is mainly used to organise the management of the business.

Differently, in the Anglo-Saxon tradition, in the USA, the need for companies to resort to the securities market for financing has preserved the original function of the company as a device for the collection of public savings. Public market financing competes with bank financing: the company has thus preserved its original function of organising collected capital. The duration in time of such a function has meant that the stock market has had to develop, in especially sophisticated ways, regulations pursuing investor-protection in order to ensure the flow of finance from the public.

It is commonly said that the American system is *market-driven*, while the continental European systems are *bank-dependent* and, in mixed economies such as Italy, they are *state-directed*.[1]

Under American law the company has maintained its function of organising capital collected from the public. Investors are protected through consumer protection techniques. Whereas, in continental law, the presence of major shareholders who are able to efficiently monitor their investments reduces the function of the company to a business organisation device, thus creating the conditions to include into the business organisation values and components other than those related to capital protection (as it occurred with regard to employees' interests or government or State holdings).

European integration and integration into the global economy impose the development of financial markets and thus the development and strengthening of the model of the company allowing direct access to them. In the globalised economy, there seems to be a convergence towards the publicly-held company model, along the lines of the US model. We will therefore look at this model first.

[1] Jonathan STORY, *The Frontiers of Fortune*, Financial Times, London 1999

II

Traditional principles of company law

3. The company as a means of collecting savings from the general public.

The company is an institution of market economies which allows investment in intensive capital businesses through the collection of savings from the public. Its function is specifically *the organisation of collected capital for investment in business.*

The first examples of companies date back to the second half of the XVIII century when the industrialisation of economies (England and France) required the concentration of capital in amounts that single entrepreneurs and banks were no longer able to supply.

The company was organised through certain techniques that have allowed it to fulfil its function. These techniques have themselves given rise to *issues* that are new when compared to traditional mercantile law - issues that have arisen over time and that have been addressed and resolved through the application and the refinement of the *principles*, giving shape to the modern company.

4. The techniques of the company.

The following combined techniques constitute the device for the collection of public savings.

a) *Limited liability.* The company is liable to the extent of its assets – the directors are not liable for the company's obligations and the shareholders are only liable to the extent of their investment.

b) *Shares: securities and membership of the company.* The company's capital is divided into fungible shares of equal value. They are negotiable and can be freely bought and sold.

The company can also collect finance from the public by issuing other securities, such as debentures. These securities merely represent a part of the financing and they are not shares in ownership.

The share of stock represents an amount of the invested capital. It also represents membership in the company in so far as it carries with it the right to vote. By casting his/her vote, the shareholder participates, according to the majority voting system, in the decision making process of the General Meeting of shareholders. The General Meeting has the fundamental powers of the *owner* of the business.

c) *Anonymity.* The identity of the shareholder is irrelevant, both vis à vis other shareholders and vìs-à-vìs the company.

This irrelevance has developed over time also to cover the nature of the shareholder, which does not necessarily have to be an individual natural person.

Companies, legal persons, entities, even public bodies or the state can all be shareholders. The nature of the shareholder obviously affects the operation of the company. However, the true nature of the company calls only for natural persons and this is best reflected in the model we are now considering, *i.e.* the US model.

d) *Stock exchange.* Shares, which represent an investment that is difficult to liquidate (*i.e.* the assets of the company), become liquid on the market. The stock exchange, by creating the market for the shares and other securities, makes the investment liquid.

This leads to the formation of two kinds of assets: *i)* the company assets, and *ii)* the share. The value of the share depends on the company assets but, through the interplay of supply and demand in the stock exchange, the share assumes its own value, sensitive to events that may have nothing to do with the company assets.

e) *Body corporate.* Legal personality is the legal formula that expresses succinctly the techniques of the company. But, in its turn, legal personality is the technique that gives the business the organisation of the *body corporate.*

Originally, the company was a combination of the following: the partnership contract, the body corporate, bills of exchange (shares) and the stock market. The company is the partnership of the old mercantile law. That is why it is a commercial contract which is granted limitation of liability through *legal personality* and with the ability to issue *shares* and other securities. The issue of securities allows access to public savings because they can be freely transferred on the exchanges since the identity of the holder of the securities is irrelevant. The irrelevance is a consequence, in legal persons, of the irrelevance of the identity of the partner (when a legal person is set up, the partner is a third party to the legal person).

5. The issues arising in the collection of public savings.

The collection of savings from the public gives rise to the problem of the protection of the minority shareholder. To this effect, special rules have developed – they are the very gist of *company law* and *securities law.* These problems were in fact new and different compared to those that the old common commercial law addressed.

a) Legal personality – institution or contract? The legal person introduces, through the subjectivity of the organisation, the issue of the *interest of the company.* In economic reality the interest of the company is broken down into the contractual interests of the members of the organisation. The legal construction, on the other hand, allows an argument for finding an *interest of the company in itself,* as a separate entity, interest which at times may be in opposition with the interests of its members. This contrast between the economic and the legal construction is also aggravated by the influence of tradition stemming from the old law, in which the privilege of legal personality was granted only for purposes of general social interest.

The contractual theories place the interest of the company with its shareholders, whereas under the institutional theories the company pursues its own interest and this must be respected by the shareholders. The consequences of this contrast were felt in the political events between the two World Wars (the *führerprinzip*), in Italy this has also been relevant in more recent years. Both in Italy and in France, social interest in the institutional perspective has been echoed in the law.

On the other hand, in Anglo-American cultures the corporate interest question comes up with less emphasis on social characterisation (the *white collar* theories). English law takes up the idea of the *interest of the company in itself* but this does not seem to have had any impact in practice.

The directors are *de facto* agents of the shareholders, although in law they are agents of the company. The majority voting procedure of the General Meeting creates a barrier between the interest of the individual shareholders and the interest of the company. The interest of the company is determined through the resolution of the General Meeting. In substance, it is the shareholders who, under the corporate contract, define their interests through the General Meeting resolutions. More precisely, it is the controlling shareholders who determine the interest and then entrust its management to the directors appointed by those same controlling shareholders. The controlling shareholder thus controls the interests of all other shareholders. The contractual balance depends on the reciprocal *strength* of the shareholders, both majority and minority.

b) *Vote: proxy, market for corporate control.* The vote generates the power to manage. The actual exercise of the vote has costs connected to it and thus depends on the shareholder's interest in voting which, in turn, depends on the amount of the investment. In practice, there is a clear distinction between those shareholders who are interested in management and those shareholders who are only interested in the revenue and the liquidity of the share. The latter shareholders, 'savings shareholders', are generally passive when it comes to voting and are actually said to vote by selling their shares. Indeed, minority shareholders enjoy the liquidity of the market, whilst the investment of controlling majority shareholders cannot be easily liquidated.

As a consequence of the passivity of the public shareholder, control and therefore management, can in fact be in the hands of a minority of the

capital, even a slight one. The separation of management from the risks of the business can be emphasised by the presence of voting limitation clauses or the recognition of multiple voting rights.

The minority is easy prey to proxy. The savings shareholder, who is not interested in voting, does not find it difficult to transfer his/her vote. He/she is willing to grant proxies, without having the ability to evaluate the content of the vote being delegated. Thus a situation arises in which the active shareholders, or the directors themselves, can easily collect proxies for the General Meetings in order to support their own policies and their own appointments. The market for votes, *proxies*, becomes a common phenomenon depending on how much freedom is permitted by national legislation. This has the consequence of changing the shape of the company as a joint enterprise, reducing the control of General Meetings and minorities over the board of directors and the majority shareholders.

The share market is also the *market of votes*. For this reason it is the market for corporate control. Given the fiduciary relationship between minority shareholders and majority shareholders, any change in corporate control interests the minority. The problems inherent in takeovers arise from this situation.

b) *Separation of ownership from control*. On one hand, the power to manage the company is concentrated in directors: they have the availability of assets (the company's assets) in amounts that it would be difficult for any entrepreneur to have, even if joined in partnerships. On the other hand, the business risks are borne by the shareholders. This is known as the problem of the *separation of ownership from control* – management power is not coupled with business risks. Business risks are borne by the formal owners who are unable to exercise control over their agents because of the diffuse shareholdings. The directors are agents without a *principal*.

When some shareholders, because of the large amounts invested, control the majority of votes in the General Meeting, the directors find their principal in such shareholders to whom they account as an agent. For this reason it is the majority shareholders who, through the directors, manage the company and therefore dispose of the interests of the minority. It follows that the majority manages the assets of the minority - they are agents of the

minority. Since the minority is diffuse, it does not exercise the powers of a principal. Also the majority shareholder is thus an agent without a principal.

The majority appoints the directors at the General Meeting. It is not unusual for the directors to be the majority shareholders or their agents. When there are no majority shareholders, because of the diffusion of the shareholdings, the directors end up appointing themselves by collecting proxies, through cross-shareholding or voting agreements, depending on the national legislation. In principle directors are liable to the company and therefore to all shareholders, although in fact they report only to the majority shareholders (if there are any) with whom they consult and reach agreement. The directors and the majority have the financial means to support their appointments and any legal disputes with minority shareholders. The directors have an incentive to hold back dividends to increase the business of the company – the payment of dividends is a cost for the company, whereas it is revenue for the shareholders. The directors can disregard the minority shareholders' reasons for buying shares, which concentrate on dividend distribution. Their position as directors means they have access to information that they can use to their advantage (e.g. insider trading) and they can take defensive measures in their own interests in the case of takeover bids. The cost of their initiatives and their defences are borne by the company.

The interests of the majority and of the minority are opposing, like parties to an exchange contract. The company is a contract with a common purpose between the active shareholders, whether controlling or influential, who act as the directors' principal. The contract becomes in fact an exchange contract with the minority. This explains why the minority is often regarded as a debenture holder. The public buys shares with votes only because of their differing price in the market for corporate control, and not to exercise the vote.

Depending on the size of the company, the concentration of power may also have repercussions for the political organisation of the State. However, we are not examining this problem at this stage.

d) *The share markets.* Share markets are anonymous in the sense that the dealing is impersonal and takes place between parties who do not know each other. The small investor, because of the amount of his/her investment compared with the assets of the company and the market volume, is unable to

negotiate the conditions of the investment, except on a very limited scale. He/she can find him/herself in a trap without realising it, because of the difficulties and the expenses involved in the negotiation and in ascertaining the investment conditions. For this reason the mechanisms of supply and demand work correctly if, and only if, the small investor is confident that the market (the issuers, the intermediaries, the advisors) is operating fairly, under protection regulations that experience has proven to work. In particular, trust is necessary since the small investor does not have sufficient knowledge to evaluate the risks inherent in price formation.

The position of the minority shareholder and of the small investor is similar to the position of the consumer, for whose protection *consumer protection* principles have been developed. However, there is a significant difference between a small investor and a consumer. In the relationship between the small investor, the company and the market, there is the intrinsic difficulty of understanding the investment's value because of its financial content.

6. The crises have prompted the legislator to identify the solutions.

It is worth emphasising that the problems that have arisen in the historical experience of crises have forced legislators to find solutions. The company, like any legal institution, is a product of experience and academia must continually review it in order for it to remain useful.

The English crises at the end of the XVIII century prompted the enactment of the first company law, *The Company Act 1856.* The American crises of the 1930's gave rise to the first securities laws, the *Securities Act 1933* and the *Securities and Exchange Act 1934.* These laws were followed in Europe, in Italy as well. Recent legal crises that emerged in the USA and in Europe have prompted new legislative interventions: solutions have already been enacted, so far mainly in the USA and France.

Most of the problems have arisen during crises and the solutions have been identified through practice and by practitioners, rather than by academia.

As we know, Adam Smith thought the company was a dangerous legal instrument because of the risk of abuse in the market and because of the political power that the size of the capital collected gave promoters. He concluded that the limited company should have been restricted to activities of

public interest (*e.g.* public utilities). The opinions of academia have slowed the liberalisation of the company in England and in France. We find this reflected in all legal systems.

6.1 The English laws of 1855-56 (Company Act).

For the first time, the English legislation allowed the freedom to constitute the company by shares with limited liability, subject to three main conditions.[2]

First of all, it set out the standard company structure in order to predetermine the rights and obligations of investors, because the number of small investors and their weak position makes it impossible for them to reach the same result through bargaining and negotiation. Standardisation is the source of the doctrine of the individual rights of the shareholder.

Secondly, it provided for the auditing of accounts and the publication of annual reports, so that the shareholder could be correctly informed on his/her investment, which is what gives the share its price. The accounts are the basis for the disclosure regime that has developed over time.

Lastly, it required the presence of more than one party in the business operation. The plurality of shareholders makes the company a social and economic reality that is different from the individual businessperson and justifies the limitation of liability arising as a consequence of legal personality. The plurality rule is aimed at avoiding limited liability when the company is 'a thing' of a single shareholder. Direct follow-up from this rule is the principle that those who abuse legal personality become liable (the so called '*piercing of the veil*'). In other words the limitation of liability is justified by the assumption that the business, being a joint one, is reciprocally checked by its members. It

[2] "Robert Lowe, who masterminded the landmark Joint Stock Companies Act of 1856. If anyone deserves the title *father of the modern company*, it is Lowe", "no matter how much modern businessmen may presume to the contrary, the company was a political creation. The company was the product of a political battle, not just the automatic result of technological innovation. And the debate forged in mid-nineteenth century Britain has shadowed the institution ever since: Is the company essentially a private association, subject to the laws of the state but with no greater obligation than making money; or a public one which is supposed to act in the public interest? J. MIKLETHWAIT – A. WOOLRIDGE, *The Company*, cit. pp. 51,53.

is a principle that is implicit in company law, stemming from the shareholder plurality rule. A principle that has been developed by academia and through experience. It is essentially a reflection of actual practice as it is probable that whoever deals with a company under the control of a single shareholder asks for guarantees to cover their exposure.

6.2 The US securities legislation of the Thirties.

The crises of the Thirties highlighted the fundamental importance of market quality for the protection of investments. Market quality has been addressed by legislators through securities regulation. This regulation completes the law of companies, in order to protect the small investor.

The primary interest of the small investor in securities is the liquidity of the investment. The liquidity must be real as it is a substitute for shareholder rights – the shareholder votes by buying or selling the shares. The small investor is more a shareholder in the market than in a specific company. When he/she happens to exercise shareholder rights (tort liability, voting at the General Meeting, overturning of resolutions etc.), it generally means that the company's crisis has advanced so far that the share has become illiquid.

Market quality depends on disclosure as well as trading regulations. Such a regulation is aimed at price determination, prevention of price-fixing, monitoring of intermediaries' behaviour (brokers, dealers, agents, investment funds, portfolio managers, financial advisors, financial analysts etc.), determination of compensation[3] and in general prevention of fraud. Most of all, market quality depends on the prevention of conflicts of interest of intermediaries who, because of their role, are fiduciaries to their clients but are, in their day-to-day business, much closer to the issuers and thus easily influenced.

M*arket authorities* vest a pivotal role in disclosure. They also aim at preventing *incompatibilities* by separating activities where necessary and imposing so-called 'Chinese walls'. The authorities' attention has been focussed on

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[3] Arthur LEVITT, *Take on the Street: What Wall Street and Corporate America don't want you to know; what you can do to fight back*, Pantheon Books, N.Y. The author was Chairman of the SEC.

accounting firms, financial analysts and merchant banks. Tort liability, in particular in the repression of conflicts of interest, is the primary sanction. In this field, US case-law has made a significant contribution.

7. The principles of the publicly held company.

Comparing national laws, we can identify the principles that have been established in order to solve the problems that have arisen. National legal systems are articulated differently, according to the development of the public company. The US law is particularly developed.

a) *Legal personality, instrumental for the interests of the shareholders, is a capitalist organisation.* The company is grounded in contract and its development can be traced back to contractual principles. The corporate interest is the interest of the shareholders in the company contract. The contracting parties become shareholders and take the fundamental decisions of the owner in the General Meeting. They decide on the appointment and the dismissal of directors as well as the running or winding up of the company. Shareholders invest in order to attain a profit. Such an interest is the interest of the company, entrusted to the fiduciary management of the directors. The company is a profit corporation.

In the running of its business, the company is limited by the protection of other interests as well as social and political values (creditors, employees, the environment, local bodies etc. the so called stakeholders). These limitations are imposed by statutes and contracts concerning these specific interests (eg. employment law, trade union agreements). They are an external limitation on the company in the same way as they are for the single entrepreneur. The company is the shareholders' business .

b) The governance of the company is the private law regulation of *fiduciary relationships* creationg individual rights and obligations and imposing a duty of loyalty.

Governance is composed by: *the shareholders*, beneficiaries of fiduciary duties, as owners; *the directors*, who are the fiduciaries; *the market authority*,

responsible for market quality; *the court*, which grants legal redress and judicial review.

The law leaves it up to the shareholders to decide whether to enforce the rights they are granted. These rights have to be real and effective. The rights are: the vote, the appointment and dismissal of directors, the pursuit of profit, the right to sue for damages, the sale of shares, the overturning of resolutions. On one hand there are the rights of the owner who manages the business (*pars quota*). On the other hand there are the rights of the investor to earn a profit (*pars quanta)*. The small investor must be able to exercise these rights, notwithstanding imbalances which result from the weakness of his/her position.

Fiduciary relations are regulated by private law. The protection they grant is effective only if the directors' liability to the market is effective. Ordinary private law is not sufficient to achieve such a protection. For this reason the protection depends on the 'sophistication' of both company and securities law. The company is a market business as it is regulated by private law and thus the risk is borne by individuals.

Company and securities regulations are based on the *protection of the fiduciary relationship*.

The regulation of conflicts of interests is the main focus of the relationship. Its implementation is entrusted to case-law, which develops sophisticated rules to ensure the independence of the fiduciary. The statutory legislator seldom intervenes. Courts are able to examine individual cases, each time confirming and adapting principles that are in the very nature of fiduciary protection. In the USA, where a developed financial market exists, case-law successfully fulfils this task. In Italy it is different, there is quite a lack of sensitivity towards this problem.

The different market regulations can all be brought back to the enforcement and protection of the fiduciary relationship. These different market regulations are the development of the fiduciary principle *e.g.* market price formation; disclosure; the auditing of accounts; the intermediaries' conduct; the treatment of inside information; takeovers; proxy voting.

The *special market authorities* are set up to reinforce the rights of who are beneficiaries of the fiduciary duty.

The market authority has to make sure that available information is sufficient truthful in order to allow investors to make conscious decisions on

their dealings in shares and on any actions for their protection. The market authority replaces investors' behavior only as far as availability of information is concerned, not for any investment decision which remains within the exclusive scope of each individual private party. Fiduciary relationships are not enforced by applying administrative law principles of protective supervision, as a substitute for private mechanisms. The market authority does not directly protect the fiduciary relationship, indeed it is supposed to create the conditions that make it possible for the beneficiary to protect him/herself if he/she so wishes.

c) *The protection of the fiduciary relationship is effective if Court proceedings are effective*. The inefficiency of judicial procedures reduces the effectiveness of court monitoring and makes the protection of fiduciary relations worthless. This is much the case in Italy, where the abundant market regulation often remains ineffective. *The court* is a fundamental component of company governance.

d) *Radical liberalism*. American authors have put forward some radical conceptions of market liberalisation. It is argued that the costs borne for the application of regulations are not mirrored in the investors' returns. The investors, according to this stream of thought, suffer the lowering of profits that they would have otherwise earned, without the regulations. Regulation of insider trading, takeovers, disclosure, auditing etc. are all burdens that the market could save on. From this viewpoint, market freedom includes the freedom to deceive. The rationale is that over time and through competition, the 'proper' initiatives will take the place of any incorrect market operator. The market will select the best, with regard to correctness as well.

This principle of market organisation has not been taken up in national legislations. However, it is worth recalling it since it is often confused with deregulation principles that are, on the other hand, better understood as policies for the updating of regulations. In Italy, the administrative supervisory regulations should be substituted with the private regulation of the market.[4].

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[4] Guido CARLI, *Lacci e lacciuoli*, Introduction to the Confindustria conference in Portofino, October 1997, published by LUISS University Press in 2002.

The fiduciary relationship must be legally protected – entrusting it to moral values and to competitive selection is never enough. It must be protected through private law and not entrusted to the care of an administrative protective supervision.[5].

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[5] Gustavo VISENTINI, *Corporate Governance: The Case of Banking*. In *Property and Corporate Governance of Banks.* Banca Nazionale del Lavoro Quarterly Review, March 1997.

III

The Company as the legal structure for large businesses: the Italian experience

8. The structure of the financial system shapes the company.

The need of companies for finance through direct access to the market shapes company law towards the market model.

Where business financing is mainly through banks, with minimum access to the stock market, the regulation of companies takes a different approach. In such circumstances, there is hardly any reason for governance mechanisms focussed upon the protection of market investors. Neither is there any need for the development of sophisticated financial market regulations. The protection of minorities is essentially assured by shareholder rights since such minorities are active shareholders. There is hardly any need to ensure investor rights, since their role is minimal. Indeed, in this banking-oriented context, any such regulations (aiming at the protection of the public investor) would be uselessly burdensome and would end up hindering the decision making process.

In such a system the regulation of companies is limited to giving shape to the running of businesses: the structure of the company then serves the purpose of composing the interests of the shareholders who are generally able to protect and enforce their private interests through common contract law. The company has the characteristics of the family business. Even larger businesses can remain under the control of individual families as controlling shareholders. This phenomenon is called *family capitalism*.

The company remains a closed one even when the shareholders are banks or other financial institutions: they supply the risk capital and the financing that the families cannot supply and that the market is unable to provide. In Italy, examples are IRI, IMI and Mediobanca. Under these

conditions the actual function of the company as a legal device to shape the business organisation stands out even more evidently. Therefore, it is not completely improper to refer to such companies as *business foundations*.

The limited number of small investors does not affect corporate governance and it is not necessary to provide specifically for their protection. Indeed, the actual protection of small investors follows as a result of the proper functioning of the relationships between the major shareholders of the company, who include public bodies and banks subject to special protective supervision. In large companies the proper running of the business is entrusted to these shareholders, their independence, their prudence and authority. Good examples are the cases of IRI (when it was founded) and of Mediobanca because of the positive results they obtained in the reconstruction and development of Italian capitalism after the Second World War.

The Italian academia and literature of the Sixties noted that IRI and other similar entities (such as banks specialised in industrial financing, IMI and Mediobanca as well) financed businesses through both risk and credit capital. Being at the same time shareholders and lenders, they monitored the management of the company entrusted to the directors. They thus performed those tasks that in the United States are generally the small investors' tasks. The Italian market does not have those small investors because of the historical conditions of our securities markets. This is the so-called *Italian version of the public company*.

As a matter of fact the serious crises that followed the World Wars, coupled with the traditional and widespread mistrust in stock investments, have imposed state intervention in order to favour reconstruction. The conditions were thus lacking for the development of the stock market as a prevalent instrument for the financing of business. Moreover, Italian tax legislation disfavoured the collection of savings from the public through the stock market, in order to avoid business risks falling directly on the unprepared small investor. A policy choice was made in favour of banking and financial institutions: it was thought that the system, not being used to direct investment in industrial and commercial businesses, would not have been able to stand the panic inevitable crises would cause in small investors. To protect public savings, preference was given to bank deposits and State guaranteed bonds. This is the capitalism of a mixed economy and it has characterised post-war Italian industrial development. Some authors have identified the reasons for the scarce interest in industrial innovation in these conditions for the financing

and governance of large businesses - as we know, in Italy industrial innovation is concentrated in the many medium-sized family businesses. The argument is that the prevalence of financial experiences, rather than industrial experiences, in the governance bodies of businesses, has actually reduced the propensity towards industrial risk.[6]

9. The company as a device for the organisation of business.

Over time, the company has come to take on differing functions.

Instead of being the organisation of the capital invested in the business, the company becomes the organisation of the business itself, as *a technique for the organisation of the business.*[7]

The company then becomes the sinthesis of the different interests involved in the running of the business. In particular, the interests of the employees (whether formally or in practice) or the interests of the State as a shareholder or of local collective bodies, depending on the nature of the shareholder. The contractual nature of the company is lost, the aim of pursuing profits to remunerate the shareholders' investment *blurs*, as recognised by several authors. The stable presence of banks, subject to close public supervision, makes it possible for political and public directives to be transmitted into the largest companies. Indirectly the State, government and public administration become a fundamental component of company governance. Protective supervision leaves recourse to civil law for the protection of the fiduciary relation to the very sidelines and thus so too the development of private market law. It is the company of a mixed economy, similar and in practice interchangeable, with the state-owned economic entity.

Using the company not as a means of access to the stock market may occur, without altering the nature of the company, to the extent that such use

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[6] GALLINO, *La scomparsa dell'Italia industriale*, Einaudi, Torino 2003.

[7] PILLUSSEAU, *La Société Anonyme, Technique d'organisation de l'entreprise*, Sirey 1967: "*La société se définirait alors comme l'ensemble des regles juridiques, des techniques et des mecanismes destinés a l'organisation juridiques et la vie d'une forme de production ou de distribution d'un organisme économique: L'entreprise*"; also, my own, though not so recent, study on *Partecipazioni pubbliche in società di diritto commune ed in società di diritto speciale,* Milano 1979.

is the result of the individual will of the parties (private autonomy). However, in Italy this phenomenon became physiological due to the features of the financial circuits. The result is not the anomalous use of the company, but a new and different entity.

This situation was necessary, as recalled above, for the financing of industrial reconstruction. When, over time, this financial structure dominated by banking and State intermediation (very effective for the contingent situation) became permanent, malfunctions arose and were emphasised by the opening of the markets to European and international competition.

European and global integration push companies towards the savings market, whose effective presence becomes a necessary condition for development. But the savings market is unable to satisfy the demand for finance because of the shortcomings in the securities markets. On the other hand its development is hindered by the lack of regulations that may confer greater trust to public savings. The adoption of such regulations promotes, through private law, the deregulation of the mixed economy, creating the conditions for the mobility of capital and corporate control in competition. A conservative attitude towards any alteration of the ownership structures of banks, finance and industry - which is the legacy of family capitalism and mixed economy tradition - has forced the introduction of regulations whose novelty turned out to be only a façade. The anomalous development of groups of companies, chains of control, the so-called 'Chinese boxes', the so-called banking foundations, and the universal bank, are all examples of how the dominant conservative attitude preserved the status quo despite the new laws and regulations.

The banking and financial sector reforms in the Nineties, responding to European integration, are the product of such a compromise: they use new formulas and slogans but the end result is the preservation of the mixed economy. The pathological consequences of this attitude are before everyone's eyes today[8] (the recent *Parmalat* and *Cirio* scandals are significant examples).

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[8] Gustavo VISENTINI, *Mixed and Market Oriented Economies: The Italian Situation* (2000), Pallas Lectures, 1995-2000, Nijmegen 2001.

10. European Integration.

The experience of these last ten years has taught us that, in order to promote the creation of publicly-held companies, it is not sufficient to change company laws and securities laws when no change is made to the financial system. It is not a matter of law – it is the system that needs to be redirected. The quality of the policy plan and the integrity of its implementation are of fundamental importance.

It is commonplace to introduce the issue of morality into discussions regarding recent legal crises. I follow with much interest and I frankly appreciate the calls for *business ethics* that philosophers, economists and politicians address to market operators. As jurists we know that for the interpreter, for the judge, the ethical criteria stem from the law, that we must respect, grasping the essence of its policy motivations: this criteria must be followed when applying the law to real life cases. For the interpreter, ethics derive from the correct application of the spirit of the law, supporting the morals of the legislation and avoiding elusive interpretations. Business ethics is the primary task of the legislator, whose role is to give us a moral law. The law is not supposed to betray the moral aims put forward by policy makers. Indeed, I found that this betrayal took place in the compromise reached in the recent Italian legislation on companies and securities markets.

The competition between market financing and banks is an issue for European integration. Its solution will affect the development of securities markets and the law regulating businesses, from company law to bankruptcy law. These are certainly not domestic issues, they have become a key European preoccupation.