The “ethical” developments of corporate law after scandals: USA and Italy

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Introduction

In the following thesis I am going to present some events in the business world that changed the way several jurisdictions approach to inappropriate behaviors in corporate governance.

The critical eye is going to focus on the human behavior at the beginning of the most significant business failures in the last decades that sapped the public opinion, and forced the governments to adopt new codes and more restricted patterns of control.

Historically each company’s collapse has driven to relevant law developments. Think to the Sorbanes-Oxley Act in 2002, as reaction to the Enron’s scandal. Nonetheless human beings have always found a way to elude the rules, damaging the weakest counterpart, making History repeats.

The “bad” behavior can take place because of the information asymmetry. The whole challenge is played on the mitigation of the principal-agent problem.

The latest mitigation theories appeal to two different aspects: the ethical behavior of the human factor, and a more restricted and interactive control system, based on transparency, in business realities.

Even more restricted is the control system where the principal represents a relevant portion of the society, think to the American public companies or to the Italian società per azioni (S.p.a.).

For the analysis I consider the study of several relevant contexts.

A context refers to all the features and variables existing in a certain social environment. In my point of view we could reassume everything in one word: culture.

Culture influences the way people make decisions. If we have a clear view of the context, we can better understand the bonds between the actors within society.

Accordingly to an interesting new current the traditional pay-off between opportunity cost and the mere profit is shaping in something more complex (and maybe more complete). Social variables influence the way to do business. Corporate social
responsibility and ethic finance are known concepts to entrepreneurs, managers and stakeholders.

Stakeholders mean all the subjects who interact with our business, directly and indirectly, such as banks, employees, costumers, government, local institutions and public opinion. Stakeholders are identified by their interest in the affairs of the corporation and that the interests of all stakeholders have intrinsic value. Businesses need stakeholders’ approval to thrive. There are virtuous links with all of the actors, where everyone tries to obtain value from each cont(r)act.

Companies try to build a better reputation, that helps them to achieve the expected return. Ethic finance contemplate to invest in companies who adopt ethical codes and spend resources for social purposes. Therefore in some markets companies have a concrete incentive to follow a social development path, no fading the economic reason.

“A great business is too big to be human” (Henry Ford)
Chapter 1 – Business scandals

In Western countries, recent scandals involving fraudulent accounting practices have aroused the public indignation. Real costs and debts have been hidden through creative and unethical accounting practices by Enron, Worldcom, Conseco, Parmalat and other dozens of public companies’ unscrupulous executives. Accounting tricks such as recognizing fictitious revenues, capitalizing operating expenses on balance sheet and manipulating bills were their way to do business.

Enron scandal

2001 December 2nd, USA woke up in another nightmare after the World Trade Center attacks happened less than two months earlier. The Enron’s record crack. The Texas-based energy-trading giant, declared bankruptcy. After SEC discovered a colossal accounting fraud lasted for years, Enron felt in 2 months. It was a company with 20,000 employees and revenues for 101 billion dollars.¹

Enron began from nothing, and in 15 years became the seventh biggest American company, settled in 40 countries. That was possible thanks to the freedom of commodities trading, overall after the National Energy policy act of 1992, that allowed the energy price paid by utilities to fluctuate.² At one point, the company offered more than 1,800 different contracts for several product categories, ranging from oil and natural gas to weather derivatives, broadband services, and emissions rights, and it earned 90% of its revenues from trading derivatives. And unlike traditional commodity and futures exchanges and brokers, Enron’s derivative business was not subject to federal regulations³. The “virtual” assets were accounted for the 80% of the whole business.

The house of cards began to lose stability during the Californian energy crisis, that made drop the value of the energy futures in Enron’s assets stomach. Andersen, the Enron audit company since its birth in 1983, in January 2001 discussed about dropping

² “Enron’s Power play” BusinessWeek 2001 http://www.businessweek.com/2001/01_07/b3719001.htm
³ “Fundamental of Investing” – Smart, Gitman, Joehnk 12th edition page 582
Enron as a client, and then in October announced that some off-balance sheet losses and debts would have been announced. The announcement was terrifying, $1.2 billion decrease in company value. After the scandalous news, during the investigation, Andersen admitted an error of judgment in the valuation process of Enron’s debt. That meant an overstatement of profits by almost $600m over the years 1997-2000. Looking to the role of the main characters of this sad business event, leaving out for a moment the mere financial fraud, the fact that had the most controversial repercussion on the public opinion was the Kenneth Lay (Enron’s CEO and founder) unmoved reaction to the Vice President of Corporate development Sherron Watkins’ letter about some irregularities in some financial reports. The former CEO Jeffrey Skilling left few weeks the Watkins’ letter. Therefore Lay, conscious of the imminent disaster decided to omit the fact to Enron’s employees and afterwards fostering them to invest their savings funds in the company. While the employees were unaware about the consequences of that action, Lay sold 93,000 shares and earned about $2 M.

The mass media highlighted some disquieting aspects of the story. In fact Enron was one of the more active participant to the Washington game of money-politics. Between 1990 and 2002, the company or its managers gave $5.9m in political contributions, Seventy-one of the 100 senators received Enron largesse; they included 19 of the 23 members of the energy committee, which was investigating the firm's collapse.

The following graphic shows the Enron’s down fall in 2001.
As information trickles out and the finger pointing begins, it’s clear that many people involved had spotted warning signs of Enron’s accounting malfeasance long before the company’s collapse.

The scandal led the USA Government to issue the Sarbanes-Oxley act, the first anti-fraud law of the 21st Century. The Sarbanes-Oxley act claims that the responsibility for accounting matters is on the firm’s top executives and any violation shall be worsen punished.7 We are going to give a brief overlook at the Sarbanes-Oxley act in the next chapter.

With no doubt an Enron case happened in Italy under a different name. Parmalat.

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PARMALAT FRAUD

Pre-scandal Parmalat was a huge multinational company with 213 subsidiaries in 30 several countries all over the world. Parmalat’s business included dairy products and bakery.

Parmalat born at the beginning of the 60’s at Collecchio (Parma), founded by the Tanzi family. The expansion began in the late 70’s and the 80’s. It was possible thank to new technologies in conservation, Uht, and a new packaging, tetrapack.8

The expansion passed by the acquisitions in all the continents, the more important were the acquisition in 1997 of the Canadian company Beatrice food for $140mln, in 1998 Ault food for $250mln, the South African Bonnita Holdings for $100m and the Australian Pauls for $220m. This dizzy growth gave an international profile to the Italian company, but on the other hand it made possible to the Tanzi’s family and to the executives to move funds easily from a place to another. The well-known off-shore companies. One of those companies would have captured the mass media attention after the scandal was found out, Bonlat, a subsidiary settled in the Cayman Islands.

Another important step in Parmalat History was the listing on Milano Stock exchange in 1994. Moreover Calisto Tanzi, the president and the founder of the company, through Parmalat Finanziaria owned the “Parma Football Club”.

All the financial operations were possible mainly thank the debt granted by several lending institutions and 32 bond loans for the amount of $7B. 9

Parmalat justified the continuous loans recourse, as the need to be ready to respond to eventually development opportunities offered by the market.

Parmalat’s industrial and financial reputation was strong, and it boasted of a good social image too, earned by several donations for the restoration and promotion of the home territory.

8“Managerial irresponsibility and firm survival. Pivoting the company in the aftermath of a social scandal”- Arabella Mocciaro Li Destri, pag. 93
9 “Il caso Parmalat” Dott.essa Maria Katia Di Staso 2004
The first signals of the financial instability (visible for the outsiders) were shown in February 2003, when Parmalat appealed to the investors for another bond issue for €300mln. The market did not react well. Parmalat’s shares registered a -9%, attributed to the insufficient clearness in the company communication with the stakeholders. Mr. Tanzi labeled the operation as a mistake, he revoked the bond issue and removed his CFO Fausto Tonna.

In March 2003 the Consob (the institute of market control) began to ask to Parmalat for more information about the financial company situation. In particular Consob doubted about the possibility for Parmalat to pay back the bond loan expiring in 2004. Tanzi responded that the debt would be covered with company’s liquidity. The balance of 2002, approved in March 2003 shown $4B deposited at Bank of America, and the participation, which can be liquidated easily, for almost $600mln in Epicurum, an investment fund based in the Cayman Islands.  

Parmalat tried to find useless resources through new bond issue, respectively of €300mln in June, entirely bought by Nextra (Intesa), and €350mln in September subscribed by Deutsche Bank, postponing the final showdown until November. Deloitte & Touche claimed the investment in Epicurum was not safe; suspect that became fact in December. The 19th of December Bank of America notified to Thornton (auditor company) about the inexistence of relations with the Parmalat Group, and warned that the deposit paper owned by Parmalat was a fake.  

From this point the Colecchio’s company attracted control agencies and mass media attention.

Some of the events happened in the past were interpreted with different keys, and magistrates began to ask the question worth millions of euro: Did someone actually knows?

The evidences that could have been made people aware about the financial wobbly Parmalat situation were several. For example the Parmatour foundation at the

11 http://www.ilsole24ore.com/it?cmd=anteprima&codid=22.0.1587055814
12“Cronologia di un crac” – La Repubblica http://temi.repubblica.it/repubblicaparma-ilcasoparmalat/2008/03/31/tutte-le-tappe-del-crac/
beginning of 2003. Parmatour was born on the ashes of Tanzi’s touristic activities. Already in 2004 Mr. Callisto Tanzi admitted money distraction from the Parmalat group to Parmatour, in which Mrs. Francesca Tanzi (Callisto’s daughter) was part of the board, for millions of euro.

Parmatour was the sum of different touristic assets belonged before to Hit Spa. Hit Spa’s financial papers were catastrophic. At the end of 2001 the losses were more than € 80M, and the patrimonial balance was heavily negative. That was just a picture of the wider scenario; the due debts to banks were about € 330M, with a real estate patrimony of just € 150M. In the Hit balance sheets shown unclear intragroup operations for hundreds of millions. Moreover the debt castle was guaranteed primarily by personal suretyships. It meant that if Hit spa had not been able of repaying the debts, the banks should have recouped their credits on Tanzi’s personal patrimony, composed mainly of the majority of Parmalat shares. It made banks virtually the Parmalat Group owners. Therefore the creditors committee, composed of several important credit institutions such as Medio Credito Centrale, Monte dei Paschi di Siena and Banca Intesa, who were owed an amount of € 500M, decided to draft a restructuration plan. In 2003 Tanzi signed the plan to save his touristic ill empire, with the endorsement of 38 banks. That was substantially the birth of Parmatour, in which every asset, before belonged to Hit Spa, flowed in. The plan envisages subsiding the liabilities of €310M, also through a new social capital underwriting of € 101M. The money flow should had been dispensed in three tranches. Unfortunately, only after a couple of months, Parmatour’ CEO, Roberto Tedesco asked more money to banks. Later, it was found out that some of the Parmalat’s liabilities were drown into Parmatour, and the resources that should had been used for Parmatour restructuration, were instead used for Tanzi’s debts.

The long process that followed the Parmalat crack caused heavy punishments for the main characters, such as Tanzi and Tonna, but at the same time it found out new and more complex scenarios where the auditors and the authorities could had understood the fraud before it changed forever the oblivious shareholders’ lives.

13 “Parmatour, l’inchiesta è alla svolta” 7 Gennaio 2004 – Il Sole24ore
Fausto Tonna during the process said to the officials that, even if the balance contained wrong data and fake documents, the expertise of some of the stakeholders such as banks or auditors should had driven them to find out the misdemeanor.  

Parmalat scandal began a case of study, and such as Enron facts, inspired a new deal of law enforcement in the whole western community.

The outrage involving the milk company drove the Italian Government to consider a new case, in which big companies in crisis threatened to involve in the collapse such a big amount of interests and people never been before in Europe. The law enforcement went to implement the insolvency proceedings, passing through the “D.L. n° 347 23rd of December 2003” sponsored by the Ministry of Productive businesses titled “Misure urgenti per la ristrutturazione industriale di grandi imprese in stato di insolvenza” (Urgent measures for insolvent big companies’ industrial restructuration), and few months later turned in the ordinary law “L. 18 febbraio 2004, n. 39” labeled as Marzano law.

The urgent nature of the law fit with the Government will to protect the creditors, the shareholders and the correct market going.

On the 24th of December 2003 Parmalat Spa and Parmalat Finanziaria Spa (the holding) were admitted to the extraordinary management proceeding for big companies, accordingly to Marzano law’s disposition, and appointing Enrico Bondi as Extraordinary commissioner. The most of Parmalat group firms were declared insolvent. The recovery plan was not easy to establish, mainly because of the cooked books. The CONSOB asked to the court of Parma to nullify the balance sheet of 2002; it was justifying with the dearth of redaction criteria enforcement. The main point was that the plan could not base on historical real numbers.

Now we are going to give a brief look to “L. 18 febbraio 2004, n. 39”, trying to get a clear frame of the Italian bankruptcy law.

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14 http://it.ibtimes.com/crack-parmalat-storia-di-una-truffa-colossale-1315179
15 "Parmalat Finanziaria S.p.A. in Amministrazione Straordinaria Breve Relazione sulla gestione e Situazione Economica e Patrimoniale al 31 Dicembre 2003" – Borsalitaliana.it
Art.1 sets the numerical criteria that have to be respected. The companies with more than 1000 employees in the last year, with total liabilities at least of € 1B. The limits were thought as filter, highlighting the special nature of the law.16

The companies who respect the just mentioned limits, can ask to the Ministry to be admitted to the extraordinary management proceeding, and at the same time it has to petition for the status of insolvency to the court. The Ministry, then, nominees the extraordinary commissioner. The commissioner, until the formal declaration of insolvency, rules the company, managing it with the scope to make the procedure clearer. The possibility to involve other group firms into the insolvency proceeding is a commissioner’s due, as well as the delivery to the court of the last two balance sheets, the list of creditors, financial statements and the list of subjects who claim any right on any company asset17, in the maximum term of 60 days.18

In the next five days, if the court declares the insolvency status, it nominees the judge and gives to the creditors the term of 90-120 days to do the application for joining the procedure.

In the case the Ministry does not approve the recovery program signed by the commissioner, it can turn the extraordinary management proceeding into bankruptcy.19

Accordingly to Art.4 bis, added later the D.L.’s conversion, the recovery program can dispose the pattern for creditors payback plans. Creditors can be divided by class or nature, keeping mandatory the Ministry approval. The recovery program is part of the deal (concordato), that has to be approved by the majority of creditors admitted in the procedure.

The crucial next step is the liability valuation, that has to be done quickly. The commissioner makes the creditors aware about the valuation. If any creditor disagrees, the law gives the possibility to impugn the valuation at least 30 days before the day of the judicial hearing.

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16 The limits were respectively 500 employees and liabilities for €300M in DL 347 23 Dicembre 2003.
17 D.lgs 270/99 Amministrazione straordinaria – Art. 5
18 “L. 18 febbraio 2004, n. 39” – Art. 3
19 L. 18 febbraio 2004, n. 39” – Art. 4 comm. 4
Another countermeasure adopted by Italian Jurisprudence was the signing of L. 262 of 2005 (ordinary law) - labeled “la tutela del risparmio e corporate governance” (savings protection and corporate governance) – concerning the internal control offices reorganization for public companies. The restrictions trace the SOX dispositions in IC patterns and guidelines.

DIESEL GATE – VOLKSWAGEN

A study research realized by the West Virginia University's Center for Alternative Fuels began in 2013, has found out the latest giants’ sin. More specifically, on September 2015, one of the firm leaders in automobile sector, Volkswagen admitted to cheat on emission tests in US. According to the Environmental Protection Agency (EPA), some of the vehicles, with diesel engines, had a particular kind of devise that could detect when the car was being tested, reducing the value of the harmful emissions. Procedures involving the testing of the VW’s engines began in the Old Continent too, and the results are not different from the West Virginia University’s ones. Sudden the EU reaction came by the German Minister of Transportation, Alexander Dobrindt. The latter ensured to drive a clear and exemplar investigation on the case, while the Industry Responsible of the European Commission, Elzbieta Bienkowska , restated about the EU guide lines of “0 tolerance” on fraud cases and the European willingness to make everyone subject to the EU regulation stands resolute.

Basically Volkswagen hided, through the use of a particular software, the pollution emission of his cars during the tests driven by the several controllers in the countries the Volkswagen brand is commercialized.

20 Art. 154 bis T.U.F.
22 http://www.repubblica.it/economia/2015/09/24/news/ad_aprile_la_volkswagen_aveva_avvertito_i.PropTypesi_californiani_le_auto_a_rischio_test_emissioni_-_123551859/
The stock markets reaction did not wait. Volkswagen shares quotation is dropping drastically, from 167€ of the 17th of September to 101€ of the 2nd of October, a drop of about 35% . The scandal influenced the governance strategy and plan too. The Japanese Suzuki Motors, who represented the partner for the developing of new hybrid technologies, decided to sell his participation of 1.5% of Volkswagen capital to Porsche, later a reflection drop (-3%) on Nikkei Index of his title quotation .

The whole economic aftermaths are not still measurable; as we read before for Enron and Parmalat, the wakes can be felt for years. But so far the overview is not rosy. The shareholders are preparing to sue the company for 40B€, as a result of the loss of about 25B€ on the stock market. Moreover Volkswagen should face the sanctions coming from several countries, the US one overall. The possible amount requested by the US Government is still not clear. Until the beginning of the year (2016), the maximum expected sanction was about $ 19B, as a response for the 584,000 accused engines assembled on as much vehicles on the American roads. On the 5th of January 2016, with the announce of the American lawsuit, the numbers were quite different: the range of the fine was corrected to $ 45B with a more unrealistic peak that could reach $80B. Just think that the fund addressed from Volkswagen for the case was less than $7B. While expected, the suit sent Volkswagen shares lower on the next day, trading down 4.0% at €121.30 each.

In the following graph we can notice the dramatic drop of the end of September 2015, when the Dieselgate blew up. The drop happened in the first week of 2016 was instead the reaction to the just mentioned market reaction to the lawsuit announce.

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23 The partnership was in part compromised in 2011. It had to do with a controversy solved with the re-acquisition of about Suzuki’s 19%. However the Japanese firm still had VW’s 1.5% until September 2015. We cannot assert any conclusion, but for sure the selling procedure involving Porsche was trigged by the scandal burst. – look to “Suzuki sancisce il divorzio da Wolfsburg” 2015 – Il sole24Ore - http://www.ilsole24ore.com/art/mondo/2015-09-27/suzuki-sancisce-divorzio-wolfsburg-081103.shtml?uuid=ACpLxc5&fromSearch
26 “The government’s lawsuit alleges that Volkswagen violated the Clean Air Act by making and selling vehicles that were designed differently from Volkswagen’s assertions in applications for certification to the EPA and the California Air Resources Board.” – “U.S. Sues Volkswagen Over Emissions Scandal” – The Wall Street Journal Jan 5th 2016
The German group is in a difficult situation, in fact it is called to draw a compromise with all its victims. European costumers are organizing several class actions (just in Germany 60,000 underwriters). In Italy, France and Spain several class actions are starting as well, involving the possibility to recall all the tampered car with the incriminated software (concerning about 8.5 million vehicles in Europe). They are disappointed for the impaired treatment received, compared to the $1,000 and free assistance offered by the German giant to the US costumers. In the US, however, the calling back plan discussed with the EPA was rejected by the Carb (California Air Resources Board) for inadequacy.

At last but not least, the VW’s financial sources are going to lower. The European Investment Bank (EIB) has decided to cut out all the future loans addressed to Volkswagen group until the investigations end.

EIB’s president Werner Hoyer said that if even part of the financings dispensed to VW in the last 25 years has been used for developing the tampering plan, he would be very embittered. The European Anti-fraud office (Olaf) is verifying if any irregularities occurred in the European loans management. 28

VW has received € 4.5B. It has still to pay back about € 1.9B.

27 Volkswagen shares graphic of the last 6 months (to 01-18-2016) – Yahoo Finance
On the other side, as we have seen in other cases, all the corporate bodies have been revolutionized. The first one who paid for the game was the CEO, Martin Winterkorn simultaneously president of the executive committee of “Porsche Automobil Holding”. He was replaced by Matthias Mueller who has taken the company’s guide in the most difficult time of Volkswagen History. Mueller claimed to build a new pattern, based on integrity and laws, for the board of directors. The scenario has completely changed for Winterkorn. Only in April 2015 the management board, the supervisory board and the main shareholders endorsed the ex-CEO, and guided the resignation of Ferdinand Piëch, President of the supervisory board since 2002, but sudden the diesel cheating software has been found out, all the shareholders and offices distanced themselves from the Winterkorn’s conduct.

The scandal has influenced every business crease: the governance, finance, brand image, shareholders value. It makes the final damage inestimable, but for sure colossal.
Chapter 2 – Corporate laws and their evolutions

“Corporate law deals the formation and operations of corporations and is related to commercial and contract law. A corporation is a legal entity created through the laws of its state of incorporation, treating a corporation as a legal "person" that has standing to sue and be sued, distinct from its stockholders.”

There are several patterns of corporate laws applied all over the world, but we can highlight the main leverages that allow the lawmaker to shape their own codes. The key elements are: legal personality, limited liability, transferable shares, delegated management, and investor ownership. Having a definite idea of these elements we can better understand what a corporation is. The structural characteristics make the corporation uniquely attractive for organizing productive activity, but at the same time they generate tensions and tradeoffs between the actors involved within the corporation bonds.

I think we need to introduce briefly some important notions directly dependent by the five leverages mentioned above.

The legal personality involved the assumption of the firm as a “nexus for contracts”; in the sense that a firm serves, basically, as the common counterparty in numerous contracts with several classes of stakeholders: suppliers, employees, and costumers. Legal personality permits a firm to serve a single contracting party that is distinct from the various individuals who own or manage the firm. Consequently we must say that this is possible because of the “separate patrimony”. It means that the capital subscribed by the owners is an available company’s resource. The “entity shielding” concept is useful for giving to all the potential firm’s counterparts a guarantee about their bonds. Moreover, the conferment is separated and unavailable for owners and their private creditors. This is basically the meaning of the second core characteristic, the limited liability. Corporate laws are shaped to allow a certain flexibility in the owners configuration, without affect the stability of the ordinary going business. Transferable shares is, maybe, the strongest impacted corporations attitude, that

29 http://definitions.uslegal.com/c/corporate-law/
generated a new horizon of networks and new legislative contractual cases, the stock markets. Hereby the need of having professional figures to coordinate the resources and acting for the firm sake, is what delegated management stands for. The management function is dispatched attempting to represent the owners will. The right to participate in control – generally involves voting in the election of directors and voting to approve the major transactions - and the right to receive the firm’s residual earnings, or profits, are typically proportional to the amount of capital contributed to the firm. Through the investor ownership, everyone who show off the status of investor can benefit of the already quoted rights.

Corporate law’s functions are clear, it sets the structure of the corporate form, and it attempts to mitigate the conflicts of interest among corporate constituencies, including those between corporate insiders, such as controlling shareholders and top managers, and outsiders, such as a minority shareholders or creditors. These conflicts are what economists call “agency problems” or “principal-agent” problems.  

The logic that stands below a principal-agent problem is that a counterpart has a major degree of information than the others. This phenomena is known as “information asymmetry”, and it gives to the agent a room of maneuver in which he could behave taking a personal advantage, and/or damaging the principal’s interest. The dilemmas we are talking about, are known as “adverse selection problem” and the “moral hazard”.

This means that the value of the agent’s performance owe to the principal will be reduced, if moral hazard or adverse selection problem occurred. It could happen directly or not. To assure the quality of the agent’s performance, the principal usually engages costly monitoring procedures on the agent’s actions. The greater the complexity of the tasks undertaken by the agent, the larger these ‘agency costs’ are likely to be.

After we have taken a look to the fundamentals of corporate law, we can assert that all the study cases are directly depended by corporate law efficiency. Parmalat,
WorldCom, Enron and Lehman Brothers scandals have boosted the legislator beyond new law borders. Let’s analyze the most important reforms issued in the last decades.

Our start point is the Sarbanes Oxley Act, for the most considered as the first brick toward a new conception of corporate law.

Sarbanes-Oxley Act – Overview and criticisms

The legislation came into force in 2002 and introduced major changes to the regulation of financial practice and corporate governance. Named after Senator Paul Sarbanes and Representative Michael Oxley, who were its main architects, it also set a number of deadlines for compliance.32

The Sorbanes-Oxley act is pointed as the most revolutionary law enforcement, in USA and maybe in the Western Countries, since the Roosevelt’s “New Deal”. The act created a new regulator for the accounting industry: the Public Company Accounting Oversight Board(PCAOB). To address some obvious conflicts of interest, auditors were prohibited from doing a variety of non-audit work for clients. Firms had to establish independent audit committees, company loans to executives were banned, top executives had to certify accounts and whistleblowers were given more job protection if they reported any suspicions of fraud. The act made the word “Audit” very popular in the firms’ governances, the supervising function turned from a feature to a primarily need.

Reading the second section of the Public Law 107- 204 cited as Sorbanes-Oxley Act, we understand the key definitions:

“AUDIT.—The term “audit” means an examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission (or, for the period preceding the adoption of applicable rules

32 http://www(soxlaw.com/)
of the Board under section 103, in accordance with then-applicable generally accepted auditing and related standards for such purposes), for the purpose of expressing an opinion on such statements.”

“AUDIT COMMITTEE.—The term ‘‘audit committee’’ means a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.”

The audit function is recalled immediately in the Act at the Sec. 101, in which the role of the Public Company Accounting Oversight Board is explained: “…to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors…”. The will to create a super partes controller is clear in the subsequently statement: “The Board shall not be an agency or establishment of the United States Government…”, trying to keep the Board’s members immune from political influence, even because how we have seen in the scandals above, politicians would have been involved in equivocal relations with the fallen companies’ key figures.

Nonetheless a pro-active control function is contemplated as following: “…conduct inspections of registered public accounting firms…”, “conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms…”.

If we see the PCAOB and the SEC as external “inspectors”, at the same way we see the whole of the firm’s governance subjects as introspective controllers, with the audit committee covering the principal junction in the internal audit network. Quoting Sec. 204: “Each registered public accounting firm that performs for any issuer any audit required by this title shall timely report to the audit committee of the issuer -

(1) all critical accounting policies and practices to be used; ‘‘(2) all alternative statements of financial information within generally accepted accounting principles that have been discussed with management officials of the issuer…”and
“(3) other material written communications between the registered public accounting firm and the management of the issuer, such as any management letter or schedule of unadjusted differences.’’

Therefore all the critical financial information and accounting policies have to pass under the audit committee supervision, that allows to reach a more efficacious information network, with the scope to find out potential threats at the fount. The latter reason and the direct responsibility for the balance statements and accounting policies burdened on the CEO and the CFO; making the relation contained within “decision-responsibility” mechanism clearer. Accordingly to Sec. 302 “Responsibility for financial reports” pass through the admission of the “principal executive officer(CEO) or officers and the principal financial officer(CFO) or officers, or persons performing similar functions” to certify signing each annual or quarterly report that “based on the officer’s knowledge, the report does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made,… not misleading”.

Immediately complementary to the responsibility aspect is Sec. 401: “Disclosures in periodic reports”. It dictates that all the financial reports have to be prepared following the accounting principles according to the SEC ones. The Sec. 401 gives to the Security Exchange Commission (SEC) the charge to issue the final rules for “providing each annual and quarterly financial report required to be filed with the Commission shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses.” The law wants to make stakeholders, minority shareholders and the public officers aware about the off-balance data, to better understand the company’s dynamics. Keeping on Sec. 401 we can notice another main feature about the Act, as matter of fact the SEC powers were considerably increased, touching new subjects such as code of ethic. Moreover “the Commission
shall issue rules to require each issuer, ..., to disclose whether or not, and if not, the reason therefor, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions” (Sec. 406 Sarbanes-Oxley Act). The above mentioned section wants to introduce a new management interpretation, in which there is not mandatory restrictions for companies to adopt ethic codes, but companies have to explain, why or why not, they have chosen to adopt the ethical code.

But what does code of ethics mean? The definition is included in the same section of the Act: “the term ‘‘code of ethics’’ means such standards as are reasonably necessary to promote: - honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; - full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and compliance with applicable governmental rules and regulations.”

Continuing our analysis of the Public Law 107-204, we must see the most discussed section of the Act: “Management assessment of internal controls” (Sec. 404). Basically issuers are called to publish information in their annual reports concerning the scope and adequacy of the internal control structure and procedures for financial reporting. Quoting the Sec. 404, the reports shall “state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.” Concerning the evaluation of the internal control pattern and reporting system, the Act imposes to registered public accounting firms, who prepare the audit report for the issuer, to attest the assessment made by the management of the issuer accordingly with the PCAOB’s standards.

Postponing the explanation why Sec. 404 has been judged bad by some studies, we move on the last four titles, focused on the crimes and punishments to apply. In particular the legislator was driven by the public sense of justice subsequent to the
several collapses happened at the dawn of the new millennium. He wanted to embitter the penalties for those deplorable malfeasances. Crimes such as the destruction of any relevant document for any correct evaluation will be punished heavily. More specifically: “Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States \ldots, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.”(Title 8, Sec. 802 – Sorbanes- Oxley Act).

Title IX “White-Collar crime penalty enhancements”\textsuperscript{33} responds to the necessity to safeguard the market trustable, making the subjects operating in the markets aware about the concept of “you do the crime, you serve the (appropriate) time”. The matter needed a determined intervention because of the damages inflicted by owners and management bodies to the collectivity and whole society equilibrium, so the hope was to restore public confidence in American business, heavily shaken by huge corporate scandals.

For sure the Sorbanes Oxley Act has put a dividing line in corporate laws, the results however are not so clear. Mainly we could see two aspects. The former, since the SOX act was signed in 2002 by George W. Bush (who called its tough new rules the “most far-reaching reforms of American business practices since Franklin Roosevelt was president” ), some politicians and business men criticized the real feasibility of the code. The reasons were several, top of the list was the price of compliance; the cost of implementing SOX’s provisions, particularly section 404, far exceeded the modest sums initially predicted. Moreover SOX was accused to undermine the America’s entrepreneurial spirit and competitiveness. Barely a year after it became law, William Donaldson, then chairman of the Securities Exchange Commission (SEC), wondered if by unleashing “batteries of lawyers across the country” the legislation would lead to a “loss of risk-taking zeal” due to a “huge preoccupation with the dangers and risks of

\textsuperscript{33} Sorbanes Oxley Act
making the slightest mistake”. The second aspect was about the above mentioned disequilibrium between costs and improvements.

With the aim to give findings and to prove the concreteness or not of these reprimands, I have drawn on the paper “SOX after ten years – A Multidisciplinary review” by Professor John C. Coates and Professor Suraj Srinivasan at Harvard Business School.

The tasks of estimating either the benefits or the indirect costs of the Act are at least an order of magnitude more difficult than the task of estimating direct costs. Before talking about some data, let’s give a short review about the new hybrid public/private body created by the Act: the Public Company Accounting Oversight Board. It “is a non-profit private corporation charged with the public function of overseeing auditors of SEC-registered companies with the goals of protecting investors and the public interest in the —preparation of informative, fair and independent audit reports. PCAOB‘s main tasks are to register, set standards for, inspect, investigate, and discipline public company audit firms…”

PACOB was a consequence of the chose not to let the charge to the SEC, nor to the private hands of the American Institute of Certified Public Accountants (AICPA).

The paper highlights several findings regarding the critics moved to the Act. About section 404, which requires attestation of IC systems, the authors names it as a comply or explain regime. Indeed it permits companies to allow IC systems to contain weaknesses, as long as that fact is disclosed as part of their own disclosures and by the audit firm providing the attestation.

Significant is the study conducted by Rice, Weber, and Wu (2013), that shows the low incentives for timely reporting about internal control weaknesses. They find firms that do not report a timely internal control weakness and later have a restatement are in fact less likely to have class action lawsuits, SEC sanctions, and management and auditor turnover, compared to firms with restatement where the internal control weakness had been previously reported. To better understand the effective relevance of that aspect, Rice and Weber (2011) find a significant proportion of firms fail to report material

34“Five years under the thumb” – The Economist http://www.economist.com/node/9545905
35 “SOX after 10 years – A multidisciplinary review” page 4 – J.C. Coates and S.Srinivasan
weaknesses when they exist. Only 32.4% of firms that in a second moment made a material restatement previously reported a material weakness. That is, most firms did not report the IC weakness when it existed, rather reporting it in subsequent and more serious reports. The perverse mechanism, that we can glimpse, works as an excuse for managers, permitting them to show their unawareness about the weakness of the internal control system. However, the SOX 404 in operation, may not allow firms to continue to maintain IC systems with weaknesses. Driven by market forces, the issuers corrected their IC systems. Johnstone et al. (2011), found it on a sample of 733 US firms who disclosed material weaknesses in 2003.36

The new regulation has shaped the US markets. Making difficult for a lot of firms to respect new standards and to face new costs. The congress’ ambition was to improve the quality of the public companies operating on the American indexes.

The following are the findings of several studies on the US firms’ trend. The features considered are three: “to go private”, to “go dark” (deregister their common stock and thus suspend their SEC reporting obligations), and to go public on US stock markets after the SOX was signed.

36 SOX after 10 years – A multidisciplinary review” page 14 – J.C. Coates and S.Srinivasan
“Going private numbers are from Engel, Hayes, and Wang (2007). Going Dark data are from Leuz, Triantis and Wang (2008).”

Actually we have to say that the results should be judged carefully, because of several reasons linked to the economic context, that makes a company opting for going private or not. For sure, the possibility to do not face the costs of compliance requested by the SOX 404 is one reason, but even the mitigation of the conflict between investor shareholders (short term oriented) and owner shareholders (long term oriented), and the chance to use the debt leverage, are reasonable logics.

The next figure shows the frequency of IPOs (Initial Public Offer) in the U.S. by small (<$50 MM sales) and large firms, by year. The figure is from Gao et al (2013).

![IPO Frequency by Year](image)

On this graph the authors warns about the meaning of the clear drop in small firm IPOs occurred in 2001, before SOX’s passage. Gao et al., explain that, despite the SEC revising rules to reduce compliance costs burden on small companies, and then small firms being permanently exempted by Congress in the DoddFrank Act, the number of small IPOs has not increased. Gao et al. (2013) attribute the drop-off in IPOs to the absence of profitable small companies and technological changes that make economics of scope and ability to speed products to markets more important than in the past, giving an advantage to larger firms.

37 “SOX after 10 years – A multidisciplinary review” figure 2 – J.C. Coates and S.Srinivasan
38 “SOX after 10 years – A multidisciplinary review” figure 3 – J.C. Coates and S.Srinivasan
Accordingly to the accuses regarding the loss of competitiveness of the American corporate law, measurable by the attitude of US body law to attract foreign firms, we can give a look to the following graph. The numbers of foreign firms who have listed in US over time is the red line, and the number of foreign firms who have delisted over time in US is the green line.

Data from new listings are from Piotroski and Srinivasan (2008) and for delistings are from Hostak et al (2013).³⁹

³⁹ “SOX after 10 years – A multidisciplinary review” figure 4 – J.C. Coates and S.Srinivasan
Now we are going to face another important provision originated from SOX’s Sec. 806. The next paragraph is going to expose the *whistleblowing mechanism*.

**Whistleblowing**

Sec. 806 “PROTECTION FOR EMPLOYEES OF PUBLICLY TRADED COMPANIES WHO PROVIDE EVIDENCE OF FRAUD” in 15 U.S.C. § 1514A. “Civil action to protect against retaliation in fraud cases” affirms that, for whistleblowers protection involving employees of publicly traded companies: “No company…or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—“(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—“(A) a Federal regulatory or law enforcement agency;“(B) any Member of Congress or any committee of Congress; or“(C) a person with supervisory authority over the employee…; or “(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.”

Sec. 806 aims to empower the IC system, safeguarding the whistleblower’s normal going in the company context.

Taking a step back let’s see what a whistleblower is.

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40 U.S. Code § 1341 - Frauds and swindles
41 U.S. Code § 1343 - Fraud by wire, radio, or television
42 U.S. Code § 1344 - Bank fraud
43 U.S. Code § 1348 - Securities and commodities fraud
In the general conception the whistleblower is the employee who notices a possible situation (fraud), that could prejudice customers, shareholders, society or the firm’s reputation, and for this reason, he decides to signal the situation to internal or external offices accountable for control. That makes every employee part of the Internal Control system, with no relevance of the covered position in the organizational chart.

This figure has begun to be an important piece of the puzzle when in the last decades several scandals happened. Accordingly to “The Economist”:

“Whistleblowing has been on the increase since the 2007-08 financial crisis sparked a crackdown on corporate corruption and collusion. The number of tips received by the “Whistleblower Office” of America’s Securities and Exchange Commission (SEC) has risen steadily since it was opened in 2011, to nearly 4,000 a year. “We live in the age of the whistleblower,” says Jordan Thomas, a former SEC official now at Labaton Sucharow, a law firm. Surveys by the Association of Certified Fraud Examiners, a global group for financial sleuths, consistently find tips to be the leading mechanism for unearthing wrongdoing, well ahead of audits or regulatory reviews.44

Could the business cracks have had less catastrophic repercussions if employees had reported timely any evidence of the imminent collapse? If yes, the consequent crucial question is: Why did not it happen?

The answer could be found interpreting the context where the convicted firms, we talked in the previous chapter, existed (and exists), where companies have often punished whistleblowers rather than praised them. A context made of chaos and hazy relations between firms’ management and politicians, external auditors and financial institutions. The situation breathed at that moment seemed to be normal and familiar for every employee, let them overlook some unlawful behaviors. Thus we can easily deduce about the importance of the kind of atmosphere companies want to establish, letting people interact on an healthy ground.

Law, with SOX’s Sec. 806, intends to influence working context, endorsing any subject who wants to reveal violations occurred in the firm. Avoiding the common consequences adopted by the company for “telltales”, such as discharging, harassment and threats, protecting and incentivizing on the other hand.

However, the line of reasoning is not indisputable. Incentivizing employee to report violations to external agencies could turn in troubles, involving: serial submitters, and the danger that business confidential information spills out from the company. It opens new scenarios, in which the convicted part could be the whistleblower. The nature of guilt is influenced by the purpose and the document’s confidential character disclosed by the whistleblower to external offices or agencies.

However we have to keep clearly in mind that so far the payoff has been fairly balanced by the law, never forget the main aim of the institution: empowering the IC system prevent markets' unexpected awaking consequences.

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46 Actually SOX does not consider any financial incentive, but the Dodd Frank does. Accordingly to the latter: “whistleblowers who bring violations of securities law, commodities law, or the FCPA to the attention of the proper government authorities—the SEC, DOJ, or Commodities Futures Trading Commission—are entitled to between 10% to 30% of any government recovery in excess of $1 million.” – “The Dodd-Frank Act's Robust Whistleblowing Incentives” (2011) - Forbes.com

47 “Europeans have debated but so far rejected the idea of American-style bounties. “The mentality here is different,” says a London-based lawyer. “The Wild West, bring-me-the-head approach would undermine rather than bolster support” for whistleblowers. The SEC has admitted to having a problem with “serial submitters”, who file dozens of spurious claims in the hope that one will lead to a payout.” – TheEconomist.com “The age of whistleblowing” (2015)

Moving the eye on Italy, we can assert that, such as for IC patterns, whistleblowing is still an unknown word in many realties.

Accordingly to Simon Wolfe et al, “Whistleblower protection Laws in G20 Countries” (2014), Italy is labeled as country with no whistleblower law protection, rated badly in almost all the aspect analyzed by the paper, with a completely absence of any principle (adopted by other international jurisdictions) in the private sector. The study explains that rights and opportunities for whistleblowers in Italy have been limited by strong cultural factors that discourage reporting wrongdoing committed by others. Only in recent years, the public and political debate has advanced. Finally Italy seems to recognize the benefits of whistleblowing in the public sector. The first practical example is ‘Milan municipal whistleblower system’ established for employees in July 2012 that seeks to prevent corruption and other wrongdoing. For the private sector employees have no specific legal protections. While some private companies have introduced whistleblowing procedures in recent years, most of these were established to comply with the US SOX Act, which applies to foreign companies registered in the USA.
However in the last year something has moved: the 2015 anti-corruption law provides for the first time an higher degree of protection for whistleblowing, and it enhances ANAC (Autorità Nazionale Anticorruzione) control powers.

The above mentioned national agency draws the guidelines of the law, with the purpose of hindering retaliation, harassment or any behavior with mafia disposition, mainly in the public sector. With the proper corrections the Italian scene finally seems to follow the international principles. For sure it is an important step toward the governance efficiency, but we have not effective findings yet, that could prove the law dispositions are completely absorbed by the business real conditions.

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Chapter 3 – Codes of best practices, CSR and ethical finance

The phenomena that catches my attention and, maybe deserves more space, is the apparent mechanism that makes the markets push companies to solve their IC weaknesses or any other lack in the communication process (disclosure) with the outsiders. A wide overview about Western countries’ corporate laws, let us think about a growing awareness of the market actors. We can affirm that, for example, looking to the best practices codes adopted all over the world, and the popularity of Corporate Social Responsibility (CSR) and ethical finance approaches.

Codes of best practices

Following the UK’s lead (the City of London first issued a corporate governance code in 1992), all European jurisdictions have now adopted a corporate governance code that draws guidelines for public and listed companies, addressing board composition, structure, and operation. It was mainly a consequence after several corporate scandals. The codes are drafted by market participants under the watch of a regulatory authority.\(^{51}\) It is no mandatory for listed companies to follow these guidelines, but such as SOX’s title IV and other jurisdictions like UK, Germany and Italy, companies have an obligation to report annually whether they comply with code provisions and, if they do not, they have to explain the reasons of their noncompliance. It is known as the ‘comply-or-explain’ rule. The best practices codes are pretty similar across the several jurisdictions, however, they differ on the fact that the codes are embodied in “hard laws” (like the Sorbanes Oxley Act), rather than in semi-voluntary codes (like in Italy).

The Italian law frame is constituted by the ‘codice civile’ and the TUF (Testo Unico della Finanza). The Codice Civile imposes the structure of the governance and the bonds, duties and responsibilities of any subject who interacts with the firm, while the TUF rules the operations of issuing or trading any kind of securities on the market. These two codes represent the ‘strong’ (mandatory) law.

On the other hand, “Il codice di autodisciplina” is the voluntary best practices code adopted for public companies in Italy. It was issued in 2006 by the ‘corporate governance committee’, and then modified in 2010 and 2014. The code allows listed companies to follow, entirely or in part, its dispositions. It remarks the UE Recommendation n. 208/2014, involving the ‘management relation’, that has to be in compliance with the codes principles, and if not, the issuer (the company) has to explain clearly how the reality does not fit the code’s principles.52

Now we are going to analyze the main points of the code, touching the relevant issues able to arise the classical agency problems, shaping a 360° control system, where all the members of the company’s governance bodies are involved in a virtuous circle of cross-auditing.

The main role is acted by the Board of Directors that guides the issuer, organizing the correct execution of its functions. The directors manage with awareness and autonomy, pursuing the creation of value for shareholders in a long-time horizon.

For the firms who adopt the “Codice di autodisciplina”, the board of directors has to judge the quality of the internal control system, and the risk control system at least every 3 months. Moreover, it is a board duty, the act of monitoring the directors status, verifying the commitment and professionalism of each board member, with the aim of avoiding the overlapping of charges or the lack of presence during the board reunions. The board has to express their evaluation about all possible critic points involving its members and committees, clarifying for example:

- the reasons why the shareholders’ meeting launches the competition prohibition exception, art. 2390 C.c.;
- the role of each member of the board (executive, non-executive and independent),
- the relations existing between the issuer’s governance and the associates’ and subsidiaries’ ones.

52 “Codice di autodisciplina” – Borsaitaliana.it
The Article 2 of the “Codice di autodisciplina”, coherently to the international best practices, suggests not to concentrate too much power in one subject. More specifically, if the CEO is the person who also controls the company, or the president of the board, the directors should institute, as counterweight, the figure of the *lead independent director*, who represents the benchmark for the independent directors and coordinates their functions.

The figure of the independent director is one of the more interesting measures in the best practices codes. The internal control system, in that way, touches directly the composition of the management body. Following as source the Italian voluntary code, the independent director is who, neither indirectly, has had any contact or relation with the issuer. Obviously the nature of the relation above mentioned, has to be able to arise a conflict of interest or a clear influence on the company operation. The independent status has to be judged by the board of directors.

The independent directors’ function is revealed in the nominee committee. The nominee committee is the internal agency, composed in majority of independent directors, who states opinion on the dimension and composition of the board, and on the professional profiles of the directors.

Historically the nominee committee was thought as counterweight in systems with a disaggregated ownership structure, where the shareholders have a limited supervisory on management’s actions. However it is a useful tool for high concentrated-share systems as well.\(^{53}\)

The discretionary character of the code permits to consider independent a director based on other circumstances. For example, the independent director who is nominated non-executive director in a subsidiary or in a related company, could not undermine the status of independent, keeping clear that his reward should not be tied to connected operations between the two firms. At the same way, the independent director who owns (directly or not) a certain percentage of shares that does not make him unable to control or to influence the company outstandingly, could compromise, de facto, his

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\(^{53}\) "Codice di autodisciplina" – Borsaitaliana.it
independency. The corporate governance committee does not prescribe the boundaries on commercial, financial and professional relations between independents director and related companies neither. In fact, the due to establish the relevance of those relations is up the board of directors. The room of maneuver, granted by the code, should push the issuer to highlight the conflicts of interests based on contextualized evidences. The conflicts of interest are part of the potential threat that harm the IC system, and should be kept under control by the “risk control system”. The “Codice di autodisciplina” defines the risk control system and nominee committee’s function as help for the issuer in the attempt to fit the strategy objectives, fostering aware decision methods. The control systems contribute to safeguard the entirety of the social capital, the efficacy and efficiency of the company’s processes, the trustable of the financial information flow and the law respect. The code gives an overview on the subjects involved in the control systems, so they are:

- The board of directors, with a specific regard for the internal control committee and the directors in charge for the committee establishment,
- the internal audit supervisor, who verify if the internal control system works and if it is adequate,
- other roles with mansion involving the control systems at any operative level, and
- the board of statutory auditors, who verifies the efficacy of the accounting rules and of the systems above mentioned.

The code suggests to coordinate the subjects’ supervisory actions, improving an efficient system working on different levels. The line controls (or operative controls), the management control and the internal audit should be seen as an interactive pattern who works for the company’s wealth and integrity.

As the Italian ‘Codice di autodisciplina’ analysis finishes, we better define the range and relevance of the subjects involved, compared two possible market configurations, represented by Italy and USA.

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54 Articolo 7 - “Codice di autodisciplina” – Borsaitaliana.it
55 “Codice di autodisciplina” – Borsaitaliana.it
The Italian public companies’ shareholding is typifying by dominant shareholders. Giving a brief look to some data, about the Italian stock market, we can later state some considerations about some best practices mechanisms.

The amount of the Italian listed companies’ capitalization is about €556B. This number alone does not give us an exhaustive frame, but we can say that it is no so notable, overall if we compare it to the amount of capitalization of US listed companies, $18,668B. For sure, we can assert that stock market acts a different social role in their respective national equilibriums. Another relevant aspect to emphasize, if we want to understand the adaptation of the international best practices trend, is the nature of the investors in Italy, focusing on the role of the private investors (or better, households) that directly characterizes the grade of concentrated shareholdings.

The following graph gives us the weight of the Italian households' presence on the Italian markets.

However the 18% can be deceptive, in fact we are going to be surprised that only the 1.7% of the families’ portfolio is composed by listed companies shares.

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56 “Listed companies capitalization on 30th September” (2015) – Borsa Italiana – Borsaitaliana.it
58 “Investitore retail, un asset per il mercato italiano” 2012 – Borsaitaliana.it
We can affirm that the presence of Italian households in listed companies shareholdings is marginal beside other realities.

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59 “Investitore retail, un asset per il mercato italiano” 2012 – Borsaitaliana.it
The figure shows the percentage of common stocks in each country that is owned directly by households. Obviously the different structure of the Italian market gives new interpretation on best practices tools.

Another significant peculiarity of the Italian market is the robust presence of families or the only-owner in the firm’s governances. It is explained by the companies’ modest dimension that characterizes the average Italian enterprise.

In the first row of the figure we have the percentage of the Italian companies owned and controlled by families (72.1%), and the companies with no notable families’ presence in the governance (27.9%). The second row shows the nature of the dominant shareholder in the two several kinds of corporations. The numbers drive away any doubt, both columns vaunt an overwhelming existence of families or individuals as dominant shareholders, with an average of 89.7% on the total.

This last feature leads to new considerations about the way best practices affect the Italian reality.

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60 “Fundament of Investing” 12th edition, page 3 - Smart, Gitman, Joehnk
61 Rapporto annuale ISTAT - “CAPITOLO 2 Il sistema delle imprese italiane: competitività e potenziale di crescita” (2013)
In particular a research made by Lorenzo Patelli and Annalisa Prencipe at Erasmus School of Economics of Rotterdam and Università Bocconi of Milan, studies “The Relationship between Voluntary Disclosure and Independent Directors in the Presence of a Dominant Shareholder” (2007). The paper tests the relationship between two control mechanisms (i.e. voluntary disclosure and independent directors) within a setting characterized by the presence of a dominant shareholder. According to the Agency Theory, both of the mechanisms are able to reduce the agency costs arising from the separation between ownership and management. The consulted sample, examined in the empirical test, is composed by non-financial companies listed on the Italian Stock Exchange (i.e. Borse Italiane). Independent directors and voluntary disclosure “can be both internal and external mechanisms: the former control and orient managers’ behavior (e.g. corporate governance structures or compensation packages); the latter provide information about managers’ action to external stakeholders (e.g. financial statements and voluntary disclosure)”62. Independent directors are expected to act with the purpose of assuring the respect of legality and limiting agency problems, such as the risk of collusion of the board members with the CEO (in Italy very often the CEO is also the dominant shareholder or a very closed person to him) and reducing occurrences of financial statement fraud. On the other hand we have the voluntary disclosure that aims “to reduce the agency problem between insiders and outside shareholders or lenders, providing information about financial and non-financial results achieved by managers. The Agency Theory (Jensen and Meckling, 1976) posits that insiders have incentives to provide information about their activities instead of leaving to the outside shareholders the task to investigate about them. This is because the costs managers to disclose such information (the so-called bonding costs) are lower than the costs the principals would bear to control insiders’ activities from outside (the so-called monitoring costs).”63 The paper examines a sample of 175 Italian non-financial listed corporations. The several analyzed variables are based on

firm’s reports and on the composition of the board of directors, keeping the awareness of potential gaps between the official and the de facto situations unyielding. The conclusion highlights the positive correlation between the number of independent directors and amount of voluntary information disclosed by the companies in their annual reports. Findings provide support for the study’s expectation, that is the internal and the external control mechanisms tend to coexist. The most interesting implication, for the present thesis, supported by the empirical evidence consisted by the insiders’ behavior “insiders are more willing to disclose information that allows a better understanding of their current performance when, ex ante, their opportunistic behavior is limited by the monitoring activities carried out by the independent directors.”

In the following I am going to cite the study’s results paragraph, with the main commented statistics: “On average, companies in the sample report 1,822 million euro of Total Sales and 0.39 of the Equity to Total Assets ratio (LEV). The average Return on Investment (ROI) is 2.21% with 44 (25.7% of the total sample) companies reporting a negative operating income...On average, 35.21% of the share capital is owned by unknown shareholders (ROWNDIF). The variation in the proportion of independent directors reported by the Italian companies is high, ranging from 0 to 100%. The average ratio of independent directors to total directors on the board (INDIR) is 35.57% ... The median number of independent directors sitting on the board is three. Independent directors represent more than 15% of the members of the board of directors in 158 companies (92.39% of the total sample). Eight companies (4.68% of the total sample) declare to have zero independent directors; one company declares that all the members of its board of directors are independent. Ten companies (5.84% of the total sample) do not specify the names of the independent directors. Eighty-three companies (48.5% of the total) disclose whether their independent directors sit on other boards. One hundred and fourteen out of 308 independent directors with available information sit on more than one board. Other studies show that the average number of

64 “The Relationship between Voluntary Disclosure and Independent Directors in the Presence of a Dominant Shareholder” (2007), page 26 – Patelli, Prencipe
independent directors does not dramatically vary over time and across market segments (SpencerStuart, 2004). The mean value of DSCORE is 14.66% (median ¼ 13.77%), with a range of 0.72–47.2% and standard deviation of 7.73%. These results show that there is a good variation in voluntary disclosure practices among Italian listed companies. On average, companies disclose high volume of management information (MNGT) to discuss financial results. However, their annual reports contain little projected information (PROJ). Voluntary disclosure appears to be concentrated on current financial information as highlighted also by the low percentage of non-financial information (NONF). “

Corporate Social Responsibility

What does ‘sustainability’ mean? “It has been defined as economic development that meets the needs of the present generation without compromising the ability of the future generations to meet their own needs.” 66 For business that includes Corporate Social Responsibility (CSR) issues.

The concept of CSR stands for companies commitment to integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through companies achieve an economic balance, with environmental and social imperatives, while at the same time they pay attention to the expectations of shareholders and stakeholders. Most of the times that means a dilemma with no easy solution. Corporations have to align their social and environmental activities with their business purpose and values. The CSR has to take action from the corporation’s culture, it has to be assimilated by the whole structure and it becomes effective only if there is coherency with the company’s business strategy.

A properly implemented CSR concept can bring along a variety of competitive advantages, such as “enhanced access to capital and markets, increased sales and

65 The Relationship between Voluntary Disclosure and Independent Directors in the Presence of a Dominant Shareholder” (2007), page 19 – Patelli, Prencipe
66 “Making sustainability work”(2014), page 2 - Marc J. Epstein, Adriana Rejc Buhovac
profits, operational cost savings, improved productivity and quality, efficient human resource base, improved brand image and reputation, enhanced customer loyalty, better decision making and risk management processes.”

Accordingly to the Harvard Business Review’s article “The truth about CSR”(2015) by V. Kasturi Rangan, Lisa Chase, and Sohel Karim, there are several points of impact or “theaters” that implement multifaceted CSR systems. CSR patterns could involve from the pure philanthropy to environmental sustainability and the active pursuit of shared value. The examined sample of 142 managers reveals that the main purpose is to align the CSR program with the company’s values. However the study identifies the most common obstacle to an incisive CSR program: that is the lack of actions coordination.

Aligning CSR programs must begin with an inventory and audit of existing initiatives. The theaters above mentioned in the Rangan, Chase and Karim’s article are defined as:

1. Theater one: programs focused on philanthropy, not designed to improve directly business performance.
2. Theater two: working on existing business models, these programs want to improve operational effectiveness, through sustainability initiatives affecting the value chain, such as reducing resource use, and investing in employee working conditions, that may reduce costs or enhance productivity and company reputation.
3. Theater three: maybe the most discussed matter. Programs in theater three involve the creation of new forms of business specifically to address social or environmental challenges.

The programs classified in the last point have been in the middle of the debate regarding the relation between social welfare and business economic character, having on a side the supporters of the classic thought, social matters= costs, and on the other side businessmen who say that with the right intuition and caution the

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economic result is possible to be achieved through CSR systems as well. A good example is Hindustan Unilever’s Project Shakti in India. “Instead of using its customary wholesaler-to-retailer distribution model to reach remote villages, the company recruits village women, provides them with access to microfinance loans, and trains them in selling soaps, detergents, and other products door-to-door. More than 65,000 women entrepreneurs now participate, nearly doubling their household incomes, on average, while increasing rural access to hygiene products and thus contributing to public health. These social gains have been met by business gains for the company: As of 2012 Project Shakti had achieved more than $100 million in sales.” As consequence Unilever decides to roll out similar programs in other parts of the world.

Another example is Jain Irrigation, an Indian global drip-irrigation equipment supplier. “The company offers farmers microfinance loans to help them purchase its equipment, provides technical advice to help them increase productivity, and buys their output at guaranteed prices.” The business was drawn specifically for India’s small and low-income landholders, helping them to reduce the waste and use of water, increasing the crop yields. “For a typical investment of $500 per hectare, farmers increased their gross income per hectare by anywhere from $500 to $6,000, depending on their crops. The added value created for its customers enabled Jain to boost its top line while retaining its operating profit percentage.”

Paradoxically, in economic realities characterized by a low degree of development, achieving CSR programs belonging to ‘theater three’ is easier than other more advanced realities. That is true because of the underrated potential stood below the social surface.

However, ‘theater three’ programs are achievable in advanced countries as well. A European company commits to develop a CSR system is IKEA. Since 2011 when Steve Howard was hired as CSO (Chief Security Officer), a seven-person
executive management group was created. The group sets the company’s vision and develops its strategy. Ikea wants to achieve simultaneously the strong growth objective and a bold sustainability, along the actuation “of a range of programs related preventing child labor and maintaining other labor standards throughout the supply chain.”

Once we have identified the economic character in theater three, we should give the reason why, the others two theaters (with no certain way to gauge the direct results) are still a good investment for managers. Businessmen who agree with the nowadays trend would answer that the clearest advantage is the gain in company’s image. However that it is true only within a market with high levels of social awareness.

Just give a look the findings in the Rangan, Chase and Karim’s survey.

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To endorse the statement in the previous page, we can give a brief look to another survey, conducted in 2015 by Nielsen titled “Global survey of corporate social responsibility”. The percentage of consumers sensitive to sustainability matters is growing all around the world. The economic effect is tied to the willingness for

consumers to pay a premium price for products branded by companies that pay attention to ethical and social matters.

The Italian numbers are below the world average, but in strong growing. The 52% of Italian consumers say to be sustainability-concerned in 2015 (45% in 2014 and 44% in 2013), and the structure of the Italian CSR landscape, encompassed by big firms (with more than 100 employees) that invest in social matters in Italy is the following.

74http://www.manageritalia.it/content/download/Informazione/Giornale/Settembre2013/PDF/10_corporate_orsi.pdf
Gleaning from the Michael Porter’s vocabulary, we might say that the macro environment, where firms and stakeholders\textsuperscript{75} exist, is going to be affected by new forces, capable to change the firm’s attitude to make profit.

*Ethical Finance*

In this paragraph my intention is to show the origin of a new conception of finance, derived from the recent scandals. We are going to complete our analysis regarding the measures that an aware management can adopt if it wants to set up its firm with ethical character. So, let’s see what the Social Responsible Investment (SRI) is, and what does it concern.

The notoriety of the Social Responsible Investments grows every year all over the world, and provide new sources of credit, and new opportunities to develop profitable businesses for companies who fit some “ethical” standards. Before we begin our analysis, it is correct to have an idea about how the finance world has worked so far, throughout the role of the banks, and why a lot people believe that “ethical finance” is just an oxymoron.

The world financial crisis occurred in 2008 pushed the capitalism in a chasm difficult to overcome. It began in the United States with the subprime mortgage crisis, and then it has spread all over the World. In the later years the crisis has gathered several study points, that draw a general explanation. First of all, it’s out of doubt the lack of control about the control agencies, who has undervalued the resorting to securitization; that is, the attitude to transform assets in securities making the markets more volatile, riskier, and, as a fact, making money more expensive. This is the first junction. It helps us to make a basic distinction existing in the credit system: the separation in the finance world, based on the banks’ operative nature. So we have: the commercial bank, and the investment bank. The former has the reason of its existing in lending money to its customers for an

\textsuperscript{75} Stakeholders as the whole subjects who claim any interest in the company. Not only following the classic pattern, but government and public as well.
interest; the latter mainly trades any kind of securities on stock markets. That separation is more evident in the US reality, where there are banks specialized in one or in the other function.

The trigger that caused the crisis was pulled at the end of the 1999 and the beginning of the new millennium, when the Gramm-Leach-Bliley Act, and the Commodity Futures Modernization Act were signed, shaping the American financial scenario. The president of the Federal Reserve, at that time, Laurence Meyer talked about the Gramm-Leach-Bliley Act as a “Fed-light”\textsuperscript{76} disposition. It let the FED as supreme supervisor, but limited its activity on the financial system. The following year, the Commodity Futures Modernization Act deregulated the derivatives trading. More specifically, the amendment created a law gap concerning the lack of control on the \textit{Credit Default Swap(Cds)} trading. The Cds are private contracts between two counterparts where they “bet” on their debtors’ risk of default.\textsuperscript{77} It was the first step toward the overuse of the securitization, the new way to do bank. Moreover the SEC in 2004, applied the not-mandatory program called “Consolidated Supervised Entities Program” (CSE). It allowed to investment banks to have more autonomy in technical valuations, such as fix the capital reserves and a less restricted disclosure policy on several securities trading. The program mentioned above, however, was accepted by the principal American investment banks, letting the financial interaction flow just between the investment banks’ senior managers and the SEC’s staff.\textsuperscript{78}

Finance was getting less real and based on assets with very volatile market value. At the same time in the second half of the 2000s’, particular kind of rewards addressed to top management began to grow exponentially: the stock options. To tie the top management’s reward to the firm’s performance represent an important


\textsuperscript{78} “Dalla crisi finanziaria alle opportunità della finanza etica” pag.2 – Prof. Maria Cristina Quirici – Università di Pisa
leverage in business, but with no wisdom it could turn into a dangerous tool. It was absolutely true in our case. Rich bonuses and dividends made Investment bank’s top management mouth water. They oriented their strategies to short term results, making the pattern even more unsustainable. After 2005 with even less quality debts, American investments banks pushed the investor’s risk over the limit, that meant heavy losses when the system collapsed in 2008, and besides, as social aftermath, it enhanced the economic difference among the several social classes.\textsuperscript{79} The crisis spread all over the world, highlighted limits in \textit{ex ante} controls, able to avoid the fall, and \textit{ex post} measures as well. The first response was “Basilea 3”, in which the main aim was to assure an “adequate patrimony” for a better risk facing.

However, the fundamental issue does not seem linked to a mere reserve limit. I would want to pay attention on the reasons why, especially during the last crisis, ethical approaches to finance have begun to gather a growing consensus among financial professionals and not.

I follow the belief that ethics is an useful tool to contrast the capitalism’s dark sides, such as corruption and pathological speculation. These economy imperfections lead to resources dissipation, making the economic sustainable development mere utopia. The way to do ethical finance keeps all the traditional patterns and calculations, but it implements the relation “investment – yield ” with another variable, concerning the reflexed effect on the real economy. The discussion rests on the possibility to have concrete advantages in the market. Actually the concept is not so innovative, ethical finance lays on the classic idea that all financial entities should support the efficient transfer of assets from individuals in surplus to individuals in deficit.\textsuperscript{80}

The new conception of finance respects the environment and the human being in economic and social dimension, trying to catch profitable opportunities as well. It is a fact, the ill-fated repercussions, that we are living in, represent costs for

\textsuperscript{79} “Dalla crisi finanziaria alle opportunità della finanza etica” pag.3 – Prof. Maria Cristina Quirici – Università di Pisa

\textsuperscript{80} “Dalla crisi finanziaria alle opportunità della finanza etica” pag.9 – Prof. Maria Cristina Quirici – Università di Pisa
everyone. Corruption and pollution today bring profit to someone, but, they bring to inefficiency and give less business opportunities to everyone tomorrow. Just looking at some real scenarios, I feel to take as example the situation of the Southern regions of Italy, where the bad management and quality of financial flows, the bureaucracy maze and the lack of facilities\textsuperscript{81} have not advanced the condition to get loans for local entrepreneurs, who are discouraged because of the limited profitable investments. Some Asian situations are notable as well. The fast development of the last decades, involving the absolute absence of sustainable concern, shows us a reality with economic conveniences, but unlivable cities.\textsuperscript{82} During the 70’s we had in the USA the first examples of financial funds with ethical nature. The Pax World Fund excluded from its portfolio any firms involved in arms, alcohol and tobacco. Contextualizing the Pax World Fund’s birth, we have to say that the principle reason because of its creation was the response to the new feeling of American people about the atrocity of the Vietnam War, and the well-known social fights. In Europe, mainly in the Northern Countries, ethical funds appeared in Great Britain in 1984. The Friends Provident Stewardship Fund was the first ethical fund. In the same years, German people began to feel the pollution issue, indeed several investments were addressed to recycling and environmental sectors. In Italy ethical finance experiments began in the 70’s, with the MAG (\textit{Mutue per l’Autogestione}). MAG’s objective was to grant resources to people, who were not able to achieve bank system standards, and who proposed feasible social impacted projects. The MAG development continued until the 1991, when

\textsuperscript{81} One of the examples of the lack of infrastructures and the criminal management of financial loans in South Italy is 488/92 ordinary law. The law enforcement contemplates the possibility, for entrepreneurs willing to invest in the less-developed Italian regions, to get credit with facilitated conditions. Unfortunately the most part of money addressed to improve the economic attractiveness and profitability of the territory were dissipated in atrocious misdemeanors, such as cooked books, bribery and fake balance sheets. The Italian 488/92’s chronicle is full of inquiries and judiciary actions on the subjects who wanted just to obtain the money, with no intention to respect the law conditions. Keeping on the main point of the analysis, the unethical behavior of few, caused the social and economic condition worsening for many. For sure part of the guilt is on the inaccuracy of the whole Italian system, characterized by the soft control tools and the collusion links between some of the individuals involved.

\textsuperscript{82} “Beijing pollution hits extremely hazardous levels”, “Particle readings hit 976 micrograms per cubic metre in Beijing suburb; safe level is 25” – Cbc.ca http://www.cbc.ca/news/technology/beijing-pollution-1.3343542
some legislative acts were signed. However on the MAG example, the idea of a new Ethical Bank started. In 1994, 22 no profit organizations created the “Verso la banca etica” association, that turned into a cooperative one year later. In 1999 Banca Popolare Etica was effective, and in the same year its capital was lire 17,3 B (about €9M) with 13,000 associates.

Banca Etica’s functions have been highlighted in the recent years, basically thanks to some politicians’ concerns and professional opinions. The phenomena was not known only in Italy. As a fact, ‘The Economist’ in 2013 wrote about it: “Ethical banks are nothing new, but Banca Etica takes its name seriously. Its annual report calls for a citizens’ revolt against casino finance, the use of tax havens and speculation in commodities. Executive pay is not allowed to exceed six times the lowest wage at the bank. And it does not want to get involved with anything having to do with pornography, oil or arms (a rule that even applies to shareholders: the directors’ report raised concerns that two, Banca Popolare di Milano and Banca Popolare dell’Emilia Romagna, are now on a list of banks related to arms production and sales). Such ideas may explain why Banca Etica is small: it has only 17 branches, around 230 staff and loans of less than €1 billion ($1.3 billion), and made a profit of €1.6m in 2012. The firm provides mainly credit to the non-profit sector and green businesses. It was, for instance, the first Italian bank to lend to co-operatives of young people who farm land confiscated from the Mafia. Yet Banca Etica has attracted a broad range of shareholders. They number 38,400, of which 5,900 are firms, including 83 financial institutions. By some measures, it is among Italy’s best-run banks: only 0.4% of loans are in default and only 4.9% of loans are classified as “problematic”. And its managers seems inventive. They have set up a platoon of 24 travelling bankers to drum up business in areas far from its branches.”

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83 Such as D.Lgs. n. 19719/91 that limited the possibility to give loans to firms with social capital less than Lire 1B (about €500,000). The aim of the law was to avoid any kind of laundering attempts. At the same way the fixed standard limited the MAG’s functions.
84 “Dalla crisi finanziaria alle opportunità della finanza etica” pag.14 – Prof. Maria Cristina Quirici – Università di Pisa
85 Ethical Banking in Italy” – The Economist (1st June 2013 – paper edition)
The numbers in Italy still show a phenomena active in a market niche, but the trend is remarkable. In Europe between 2007 and 2009, so during the crisis rise, the financial resources invested in a “sustainable way” increased by 87%, passing from €2.700B to €5.000B, in which about €1.200B were invested following the Eurosif criteria of “Core SRI”, the criteria before mentioned involved a process of selectivity of the target customers regarding their ethical profile. It means: no arms industries, no nuclear energy producers, selecting all the firms and the States with virtuous governance and social policies. Following the Morningstar and Vigeo’s Report “Green, Social and Ethical funds in Europe” (2010), in Europe the number of ethical funds has grown from 683 to 879, and the value of funds’ managed assets is about € 76B.

Besides financial services customers are more absorbed about the destination of their money. In Britain accordingly the findings of a survey conducted by Abudance, an ethical investment platform, 70% of people don’t want their money invested in unethical businesses and 65% think corporate tax avoidance is unethical – more than those who think pornography or arms dealing is unethical.

The report says that when people are aware about “98% of the FTSE 100 (the 100 companies most capitalized in London Stock Exchange) engages in corporate tax avoidance as standard business practice,” 65% of those surveyed consider this corporate practice unethical, second only to child labor and human rights abuses. Far from being disengaged, 70% of those surveyed want to be in control of where their money is invested and choose exactly where it goes. But only 35% of people surveyed think that their bank is transparent about where their money is invested. We need to say that response is always influenced by the way the question is asked, but we have to admit that something is changing in companies’ governances. Accordingly to a report made by PwC 62% of all FTSE 100 companies now

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86 “Dalla crisi finanziaria alle opportunità della finanza etica” pag.16 – Prof. Maria Cristina Quirici – Università di Pisa
87 “Dalla crisi finanziaria alle opportunità della finanza etica” pag.17 – Prof. Maria Cristina Quirici – Università di Pisa
disclose information about their approach to taxation, compared with less than a third two years ago. Indeed we could suppose that firms do not want to disappoint their customers, or better the social opinion, because of its likely capability to influence directly and indirectly the company’s revenues. The direct way is obvious related to the firm’s sales. More uncertain is, rather, the relation with the financial channels. If a certain cut of financial resources available for everyone, in the past, is now moving in a new market, where just few companies are allowed to stay because of ethical implications, it is mathematical the reduction of financial channels for companies who are not in the “ethical market”. The point is, how does the “ethical market” have a bearing on corporate governance’s strategies?

The answer to the question is still ambiguous. The easiest way to try to guess future evolutions is to follow the trend, given by numbers. As we have seen in this paragraph, overall during the crisis, in which the financial services faced a brutal stop, only ethical funds improved their market share. Social awareness perhaps boosted financial subjects to do SR investments.

The main message to get, could be synthetized by the last findings of the Abudance’s survey mentioned above. It shown “that 70% of those surveyed want to invest in things “that give a good return and don’t harm our future” and 70% ” would be unhappy if they discovered their money was invested in unethical businesses.”

If we want to believe to this market’s growing concerning feeling, we can deduce that: if the actors of the financial system adopt ethical standards for their financial flows’ strategies, not only they face new financing opportunities, but they avoid to stumble upon unexpected findings that lead to stakeholders’ disappointment. It means beginning a cycle of trust and loyalty. According to the several Frederick

89 “More transparency in tax reporting” – Pwc.co.uk - http://www.pwc.co.uk/services/tax/insights/more-transparency-in-tax-reporting.html
Reichheld’s studies (Bain & Company), business oriented to investor loyalty, generates superior results compared to those engendering disloyalty.

The bad little four - Banca Etruria, CariChieti, CariFe and Banca Marche’s case

The most recent Italian financial scandal involves four little credit institutions (together the banks weight the 1% on the Italian National system in assets terms.)\(^{91}\). At the end of November mass media began to talk about the disastrous financial status of the banks above mentioned. That was not the first time, in which Italy has seen banks suffer. It happened to Monte Paschi di Siena in 2012. The oldest world bank was rescued issuing a bond emission of about €3,9B, entirely signed by the National Treasury, with an interest rate of 9%\(^{92}\).

The fact trigged a debate about the decency of saddling the State with banks’ liabilities; the procedure commonly defined as “bail-out”. The debate culminated with the new EU directives in 2013, concerning the concept of the “burden sharing”, in which shareholders and conditional bondholders have to be responsible for their bank’s debts. On January 1\(^{st}\) 2016, the frame was completed. The EU directive about the «bail-in» began to be effective, giving a clear sequence of subjects accounted for bank’s obligations. The top names on the responsibility list are shareholders, followed by conditional bondholders, creditors, and bank deposit holders with more than € 100,000 on their account.

The bail-in reform was effective just in part during the credit institution rebalancing plan at the end of December 2015. In fact the Italian government, keeping in mind the EU directive of 2013, exposed the rebalancing plan based on the “burden sharing” mechanism. Moreover contemplating a scenario of switching


between a *good bank*, made up of the healthy assets, managed by a resolution fund supervised by Banca d’Italia and financed through several credit lines of the biggest Italian credit institutes: Intesa, Unicredit and Ubi; and a *bad bank*: as a mixture of all the suffering credits, that will be sold to special subjects specialized in managing those kind of assets.\textsuperscript{93}

The saddest aftermath, however was for the conditional bondholders, mainly represented by little money savers. Most of them faced heavy losses. The Italian Government decided to establish the “Fondo di Solidarietà”, financing by € 100M coming from the “Fondo interbancario di tutela dei depositi”. The goal of the fund was to limit the economic damages the subordinated bondholders coped with, refunding some of them.

Furthermore the public opinion was even more dismayed facing the numbers, information and features found out during the following investigation.

The controversy deals with the bondholders nature of unawareness. They claim about the way they signed most of the accused titles. The technique that seemed to be used by banks’ employees consisted in not explaining with enough cleanness the characteristics of the contracts to their customers. So far, nothing was proved for sure, even the sly essence of the bargaining, but numbers occurred in the bank chronicles can give us a fair point of view: on October 30th 2013 Banca Etruria issued a conditional bond loan with a yield of 5%, while Banca Intesa (one of the biggest Italian banks) issued a title with the same characteristics with an effective yield of 6.75% addressed to institutional investors. That time the BTPs’ yield was 4.18%(State risk free bond). In April and July 2012 the same happened for CariChieti; it issued two bond loans with a yield of 5%, while UniCredit paid, in 2012, for the same kind of title respectively 7.21% and 7.41%.\textsuperscript{94} What do those numbers mean?


\textsuperscript{94} “Quei bond subordinati con rendimenti da BTP: tassi bassi per titoli a rischio” – Dec 15th 2015 – Il Sole24ore
The assertion we can pronounce with no fear is: those titles were out of any market logic, out from reality. Underwriters risked a lot, receiving back an inappropriate yield. It means, no warning light for bank customers in the moment they subscribed the bonds.

Naturally it is out of the controversy the underwriters responsibility about their actions, consisting in lack of preparation during the valuation process about the mechanism behind those financial papers, but equally true, some faded behaviors that have taken place along banks organization charts made the gap between the ‘principal’ and the ‘agent’ even more divergent.

Examining the way the credit institutions managed their credit granting policy, we can glimpse a possible explanation of their need to allocate unprofitable bonds on the market. Accordingly to the investigations, the banks’ governances did not pay attention to the loan beneficiary selection. The due diligence were supplanted by personal connections, the capability of paying back by estate warrants. Substantially banks bestowed money with absence of mind.

Looking back to the Banca d’Italia inspectors’ report about Etruria financial position of 2009 (before the Italian financial crisis peak), default credits amounted to 14% of the total loans, more specifically € 408.2M of suffering credits, €421.6M of credits with critical probability to be redeemed, €132M of expiring credits (not refunded yet), and expected losses for € 318.3M. But the most notable number was represented by the gap of valuation with the Etruria financial sheets. For Etruria’s board of directors, suffering credits were just €235M and the expected losses €57.7M. Since 2009 Banca Etruria’ governance began to ignore any vigilance communications. In 2013 about the 30% of the credits portfolio was bad. At that moment the board of directors decided to hide partially the crisis buying Btp (Italian State Bonds). In that way they tried to hence revenues through bonds negotiation, keeping the intermediation margin high. At the end of 2013 the Btp were about € 7B. The losses in the Etruria’s balance sheet was about €73 M, but

95 “Etruria, ecco il primo verbale di Bankitalia: già nel 2009 aveva un miliardo di crediti malati” - Jan 7th 2016 – Il Sole24ore
without the Btp trading operations the losses would have been about €200 M. Later Banca d’Italia criticized Banca Etruria for the excessive presence of Btps in its portfolio, so imposed to Tuscan bank to lighten the financial position of about € 2 B of Italian bonds. Banca Etruria was already on the way of a financial instability, but for a while the governance misled the market. In 2014 after the balance sheet were purified by the Btp, the capital value was of just € 500M, below the vigilance limit. Only on the 1st July 2015, after the third inspection leaded by Banca d’Italia, Banca Etruria entered in controlled administration.

Accusations were moved mainly to the governance (in which Italian Minister Boschi’s father, Pier Luigi Boschi was part of the board of directors since 2011), responsible for cooking books and omission of interest conflict to the control officers.

Accordingly to “codice civile”’s art.2391, directors have the obligation to inform and clarify, adequately, any conflict of interest involved in company’s operations to the auditors. After the deliberation, the board has to motivate the reasons why the conflict has no impact on the operation. At the same way the law allows directors who do not vote for, to impugn the deliberation in 90 days.

Directors who omit the conflict are accounted for any damage caused to the company and risk from one to three years of jail.97

Etruria’s ex-president and CEO, respectively Giuseppe Fornasari and Luca Bronchi justified their position stating that the reason why of the Etruria’s financial situation was the result of the credit market contraction, and that CEO’s responsibilities fit just in part with the accusation.98

At the same way Consob seemed to have responsibilities too, because of their insufficient vigilance on the subordinated bonds trading.
The legal process will continue for a while, shaping again the face of Italian (and European) corporate law. Any conclusion or opinion expressed on these facts would be premature, maybe. For sure it is another example of how a criminal and unethical management policy can affect the profitability of a business (bank, commercial company, or whatever) and the whole society.

**Conclusions**

Basically the text is not going to offer an absolute formula for achieving better results in business. It is not going to prove that ethical and respectful enterprises accomplish top goals neither.

The analysis has just seen the developments occurred to corporate laws (and more generally, to western societies) after some business crisis, highlighting that, even if those crucial events happened in different places in the World, they have in common some basic elements. The causes, with different tones, had their origin into the agency problem mitigation imbalance. We can assert that the law context has always reacted, trying to draw a law frame capable to avoid that analogous imbalances occurred again.

The US legislative system seems to be more advanced, compared to other realities. The implementation and introduction of all the countermeasures examined before, largely, have stars and stripes matrix. So far, the most significant legislative intervention is the Sorbanes Oxley Act, signed in 2002, as direct consequence of Enron and WorldCom scandals. The SOX mainly contemplates:

- a new regulator for the accounting industry: the Public Company Accounting Oversight Board(PCAOB);
- restrictions for external auditors assignments (avoiding that the issuer could have any other bond with the audit firm)
- incentivizing cross-control patterns (involving mandatory quarterly reports, clarifying actors responsibilities and instituting internal control offices)
• enhance punishments for who commits any infraction.

The Act has not impeded other frauds happen, but for sure it has given the basis to a new stream to follow for other jurisdictions.

On the other Atlantic side, Europe has come through a process of legislative harmonization. The actions started in the north of Europe (in England first), late spreading in the rest of the Old Continent.

In Italy, likewise everything else, the adaptation to the EU’s law trends came in a second moment. As we have seen in the paragraph regarding the whistleblower, only in the last 5 years the office became known in Italy, and only in 2015 with the ‘anti-corruption law’, for the first time the Italian Government provided official protection for whistleblowers.

However, law arrangement and enforcement still cannot achieve the main goal, to mitigate the agency problem, that is reducing the moral hazard and the informative asymmetry. So, the whole subtle thread has brought me to state that: we can glimpse, in every law reinforcement, the legislator willingness to implant the roots of a virtuous context, in which ethical behaviors thrive, that goes along every step of the business continuous.

Examples of that have been shown in the second part of this thesis, in particular we have looked to several means developed on the society need to react, giving a new and worthwhile way for people who do choose a sustainable management orientation.

As all the theories, in their first practical approaches, we cannot prove yet, their 100% effectiveness, but there are positive clues.

Corporate Social Responsibility systems can bring competitive advantages, like: enhanced access to capital and markets, increased sales and profits, operational cost savings, improved productivity and quality, efficient human resource base, improved brand image and reputation, enhanced customer loyalty, better decision making and risk management processes. Studies and business realities has shown that profitable results are achievable. New reasons and concerns shape the customer’s preferences,
underwriting best practices codes most of times represents just a minimum compliance to remain competitive on the market, and building righteous social network within the firm makes the competences spread out.

Another present issue concerns the financial crisis, the even more expensive cost of getting loans on the credit market, and the growing percentage of the credits in default has put the financial systems on the edge.

It is simple to understand that, for a good business becomes imperative to gain all the financial channels it can. Getting desirable and fitting particular credit institutes’ standards we talked before, can mean have an extra card to play. We have said that even people, want to invest money with foresight, in profitable businesses with contained risk. The Italian shiny example of Banca Etica should make us think on it: Banca Etica has less than 5% of “problematic” credit, and just 0.4% of credits in default.

All the legislative intervention would like to push toward a viable direction, but it is only feasible if a sustainable management way is adopted.

The data and graphics reported in the earlier chapters let us assume that there are fruitful opportunities to catch in the sustainable management. As all the investments directed to change the basis of our business, CSR systems required a cost is paid and a medium-long timeline to yield the return.

In the opinion arisen from my interpretation of the implicit scope of the law developments, from my study path and my experience in the US, I feel to state that beyond the ethical implications of this new way to do business, there are real opportunities for the future. A future where economic advantages shall be originated by sustainable choices, that create value not only for shareholders, but for all the stakeholders who interact, directly or indirectly, with our business.
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“In matters of style, swim with the current, in matters of principle, stand like a rock”  Thomas Jefferson

“Amare sì, impazzire mai”  Arturu u Saiolu

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