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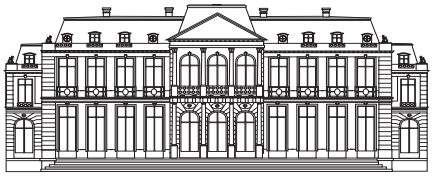

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Ladies and Gentlemen,

first of all ***let me thank all of you*** for being here today. ***I am pleased and honoured to speak before such a*** highly ***qualified audience on*** the subject of ***"Italian privatisation and corporate governance issues in the new Euro-environment"*** which is, both, ***highly stimulating and controversially enriching***.

In fact, the ***crucial challenge*** of ***redesigning a new role for the State, in an economic and financial environment that is thoroughly and rapidly changing***, brings to surface the ***differences in approach*** which have emerged ***in the major European countries*** in the pursuit of what is essentially the same goal: ***shaping the new socio-economic environment of modern industrial societies of the future.***

❒ ***EMU-ORIGINATED TRENDS IN EUROLAND FINANCIAL MARKETS***

❖ ***Interest rates convergence***

In the early spring of last year, the forward market was ***already factoring in*** a perfect ***equality of Euroland interbank short term rates***, after January 1st 1999, and pricing accordingly**;** that means ***the market was*** already ***anticipating the positive admission decision*** made shortly after (May 3rd, 1998) by the European finance ministers, regarding ***Italy's entry into the EMU league***, right from the start.

In the spot market, the recent ***start of phase 3*** of EMU, with the ***birth of the Euro***, ***has entailed***, as expected***, the full convergence of short-term interbank rates in all participating countries***, because of the termination of any exchange risk, the presence of a single monetary policy and the absence of any significant issuers' risk for short maturities.

Long-term rates, instead, although converging still ***differ because of credit risks***, which add up to half a percentage point in primary ten-year yields (Fig.1).

Italy, in particular***, is already benefiting from a "convergence dividend"*** coming from the ***alignment of the Italian yield curve to the German one, coupled,*** initially***, with a sizeable downward shift of the whole term structure of interest rates in both countries*** (Fig.2).

This ***"convergence dividend"*** is ***here to stay*** and is bound to pay out ***lavish dividends*** in the foreseeable future in terms of lower budget deficits and containment of public debt stock, in spite of the recent rise of rates at the long term end of the two yield curves.

The birth of the Euro has also increased the potential rewards for success in ***pan-European equity investment. Tight fiscal policies throughout Europe***, to comply with the ***Maastricht Treaty*** parameters***, and the ensuing convergence of bond yields*** around those of German government bonds ***have meant*** a collapse in yields in Italy and Spain, and ***declining yields throughout the European Continent. This has driven a switch of investment from government bonds into equities that partly accounts for the excellent performance of European stock markets*** vis à vis the USA and Japan (Fig.3); the rise of the FTSE Eurotop 100 index has matched that of the Dow Jones and exceeded by far the Japanese NIKKEI 500.

In the new pan-European equity market, the 11 countries of the EMU-bloc have a combined stock-market capitalisation of about $3,764 bn.
If we include the UK, which is out of EMU but deeply integrated with the Euro-zone stock-markets, the whole region ranks as the second largest stock market in the world (Fig.4); but it is ***still a long way from being a genuine regional stock-market.***
One impediment may have been ***removed*** with the creation of a single currency, but ***plenty more remain***, from tax and regulation to cultural sensitivities. ***A substantial barrier has been breached, however,*** and it is only a matter of time before investors move beyond their traditional domestic benchmarks towards a pan-European approach.

❖ ***The Euroland bond market: the success story of the Euro <u>corporate</u> bond market***

◗ ***The <u>governments</u> bond market.*** Unless one of the ***EU11*** governments behaves as a ***"free-rider"*** by running fiscally irresponsible policies (and thereby producing market expectations of diverging fundamentals) ***– the European <u>governments</u> bond market is already becoming a single integrated market*** and ***yield differentials*** arising from credit considerations will become ***narrower and more stable within the EU11 area; credit spreads***, therefore, will play a much ***smaller role under EMU*** than currently envisioned by market participants, ***while liquidity premia*** may become more and ***more important***.

◗ The ***corporate*** ***bond market***. Recent trends signal the development of deeper and more liquid capital markets. The ***development*** of the ***Euro-denominated corporate bond market,*** however, ***has exceeded the most optimistic expectations*** and has come alongside an acceleration of the process of corporate restructuring in the Euro-zone. The search for higher yields by investors, greater expertise in analysing credit risks by institutional investors, and reduced issuance by European governments have all combined to spur growth.

While the ***European governments bond market*** (USD 1.85 tn at the end of 1998) ***is of comparable size*** to that of the US (USD 2.31 tn), the ***corporate bond market is very small compared to its US counterpart;*** the latter, in fact, was USD 0.45 bn in the Euro-zone compared to USD 2.0 tn in the US. ***However***, in the first quarter of this year, ***Euro-denominated issues accounted for 44.1% of international bond sales,*** with the USD accounting for 44.9% and CHF and GBP covering most of the other 10%.

The European ***corporate bond issuance***, in particular, ***has surged at the start of 1999*** with the value of ***sales*** in the first quarter of the year ***nearly matching that seen in the whole of 1998*** (Fig.5)**;** the size of the deals has also gradually increased. This is ***a trend that is*** generally ***expected to*** gradually ***continue through the next couple of years*** - though possibly at a pace that is a little slower than that seen in the first half of 1999**.**

Tecnost (the vehicle Olivetti used to take over Telecom Italia) ***sold in June a Euro 9.45 bn bond***. This was ***a record size for a corporate bond***. It followed a Euro 3.2bn deal from Repsol and Mannesmann's Euro 3.0 bn issue. These sales ensured that, contrary to expectations, the total of Euro 29bn of corporate issuance in the first quarter of the year was easily surpassed in the second quarter. Additional issues from Olivetti are expected to add up to as much as Euro 6.5bn through the next 6 months.

The Tecnost issue is rated BBB+. This is ***symptomatic of the greater diversity of issuers*** that have accompanied the introduction of the European Single Currency. ***AAA and AA issues accounted for 46% of deals in 1Q99*** compared to ***66% in 1998*** (Fig.6). In the US the proportion is around 30%. ***There is therefore still a tendency for the market to concentrate on the higher end of the credit scale***.

Issues below A accounted for 25% of the total compared to the 13% that they represented back in 1Q98. At the end of 1998 only 1.6% of outstanding Euro-denominated bonds were below investment grade compared to 17.3% in the USD market. ***However, higher yielding*** (higher risk) ***bonds have*** increasingly ***been issued*** and this appears to be ***one sector of the market that will have major potential over the next several years***.

A broadening of the group of issuing companies would be ***expected*** over the next couple of years ***to really ensure that the market can rival its US counterpart***.

The development of the European corporate bond market is clearly linked very closely to the heightened pace of corporate rationalisation and concentration. The largest deals seem to begin with very ***large syndicated loans*** that are then ***refinanced in the corporate bond market***. The huge borrowings of Olivetti to finance the take-over of Telecom Italia**;** that of Mannesmann for acquisitions in Germany, Austria and Korea, both of which were subsequently refinanced, bear witness to this emerging trend.

The reason for that is that the loan market has the advantage of allowing secrecy in the early stages. ***The corporate bond market then provides the scope for some diversification*** of borrowing and ensures that the banks can keep lending short term in nature; ***clearly, a process of maturity transformation is at work here***, to the benefit of both the lending banks and the corporate borrowers.

The development of the European syndicated loan market follows a pattern already evident in the US with a gradual move towards a more co-operative approach that is able to spread the risk on large loans becoming evident.

There are ***two factors*** that are said to have ***bolstered the growth of the European corporate bonds market*****:** the desire of investors ***to find an alternative source of yield and risk*** now that the European government markets have become more homogenous; and the awareness by ***corporate treasurers*** that they can ***find cheaper financing outside of bank lending***.

The removal of exchange rate risk within the Euro-zone and the slide in volatility of the spread among government bonds across countries within the Euro-zone have drawn ***investor attention away from yields and towards credit risk.*** The creation of one large homogenous bond market has made it easier to sell large bonds.

An adjustment of funding is also encouraged by the desire of European banks to reduce loan exposure. Banks have been intent on increasing capital and strengthening their balance sheets rather than increasing their assets after the capital market volatility that was seen last year. There has also been a desire on behalf of the banking industry to move toward shorter term lending that does not carry any additional risk weighting under current BIS capital adequacy rules.

The desire on the part of European banks to remove low margin loans from their balance sheet is something that ***is expected to continue and this will*** continue to ***support the development of the corporate bond market.***

Investors in the Euro market have generally been Europeans with few alternative domestic investment opportunities. ***US investors have remained cautious***, wary of the exchange rate risk but will probably be pulled gradually into the market - particularly if the Euro starts to recover vis à vis the USD.

European funds that have been strong buyers of Latin American USD paper in the past ***are now happy to eliminate the exchange rate risk and buy Euro paper of Argentine and Brazilian names***. There has been very strong buying; half of these sales were Euro denominated.

The GBP corporate bond market has also seen steady issuance since the start of the year - suggesting that the introduction of the single European currency is not the whole story in the development of the European corporate bond market. ***It is believed that the dual currency pillars of USD and Euro will continue to dominate bond issuance in the period ahead.*** However, it is also believed that there will be ***scope for some other specialist areas such as GBP and CHF.***

European mergers and acquisitions reached a record high of 3,000 in 1998 and are expected to easily surpass that figure this year. The development of the corporate bond market has ***enhanced*** the ability of firms to find ***long term financing*** and has ***provided a powerful additional tool for the restructuring of the European industry.***

The successful Olivetti take-over of Telecom Italia would probably not have been achieved without the possibility to refinance its syndicated loan. It seems ***no coincidence that the largest*** non-financial and non-sovereign ***bond issues*** have been ***seen in*** the ***telecom and energy markets***

where corporate restructuring has been most intense. Continued growth in the bond market should enhance this process.

Looking forward, ***it remains to be seen whether the market can survive the removal of the novelty factor and the rise in long term interest rates*** that has been ***seen over the last couple of months.***

We suspect that there will be some moderation in activity but ***that the general trend towards increase in spread and depth of the European corporate bond market will continue***.

The ***key items*** will be ***the development of the high yield market***, the ***ability to price more aggressively*** and the ***enhancement of the range of player***s in the market.

❖ ***The rise of European fund management industry***

A study of the Bank for International Settlements ***(BIS) estimated global fund management industry to be worth 23.7 trillion dollars, in 1997***. The ***US*** is the ***largest source*** of investment funds (55% of the world managed funds), with ***pension schemes playing a major role;*** by contrast, this same item is only marginal ***in EU-11 and Japan***, where ***the lion's share*** is represented by ***insurance funds*** (Fig.7).

The dominant role played by pension schemes in the US and by insurance funds in Europe and Japan, ***mirrors*** the ***difference*** existing ***in the typology of investors' base*** and the ensuing ***difference in the mechanisms of corporate governance*** in the two regions.

In fact, whereas in the US the process of corporate governance relies evenly on a wider range of independent institutional investors (investment funds, pension funds, other major institutional investors), in Europe and Japan, instead, banks, insurance companies or financial conglomerates control most of the managed funds.

◗ ***Booming investment management in Italy.*** Although recently the ***Italian fund management industry*** posted significant increases, the ***evidence shows that institutional investment*** on behalf of Italian savers ***is low by international standards.***

If we look at the ***share of households' financial assets managed by institutional investors*** in the ***G6*** countries at the ***end of 1997*** we see that Italy scored last with a ***24.5% share*** (Fig.8), in spite of the marked improvement recorded from the previous year (it was 20.4 % at the end of 1996).
The gap, however***, is already quickly narrowing*** (the share of Italy has further risen to 28.2% in the second quarter of 1998) ***and this trend is expected to continue with Italy's participation to EMU,*** due to several reasons.

The first is the ***reduction in Italian interest rates, which will increase the need to optimise portfolio management.*** This optimisation is carried out better by institutional investors, because of their greater skills in market timing and stock picking and also thanks to lower transactions costs.

A second reason is the ***greater weight of equities in EMU portfolios;*** equities' higher volatility and degree of diversity give a ***comparative advantage to institutional investors. Economies of scale are the reason here***. This case is strengthened as equities in the whole EMU area will become more similar, due to vanishing intra-EMU foreign exchange volatility.

A third reason is the ***lower importance*** that ***Italian public debt*** will have ***for domestic investors.*** In 1997, ***Treasury*** bonds were ***106% of GDP*** and represented about ***25% of*** the country's ***financial wealth***. ***In the long run*** (about 15 years) ***a reduction of the debt stock*** of some 30% ***would*** thus ***free up about 460 trillion lira in residents' resources and about 100 trillion lira in foreign ones*** (almost one quarter of the public debt stock). These ***resources***, unless absorbed by a reduction of the savings rate, will be ***diverted towards other instruments***, that will typically be more sophisticated than Treasuries, and thus ***more viable for professional investment***.

A fourth reason is the likely ***overhaul of the Italian pension system***, which will channel ***savings into pension funds***, currently absent from the Italian scene, which is one reason for comparatively low Italian institutional investment.

A fifth reason is supply - rather than demand - driven. The ***reduction in interest rates will lower interest margins*** enjoyed by Italian banks. These will therefore have ***to develop new***

areas of business, and "Investment Management" is one of the most obvious choices as it has a high unitary added value and requires skills typically available in Italian banks.

A sixth and final ***reason*** for booming investment management ***relates to Italian corporate governance*** that has been - and to a lesser extent still is - very ***different from the Anglo-Saxon model***.

Protection of minority shareholders' interests is often ***deemed insufficient*** and easily avoidable, but ***legislative action to improve it*** has ***not*** proved ***very effective***. Increased ***favour for institutional investment*** would constitute a ***market solution*** to this problem. The optimal degree of intervention in company management would then be left to market players. If this attained ***a heightened management discipline,*** such a development ***could also increase the demand for equities***.

◗***The shift towards professional portfolio management.*** This phenomenon ***is bringing more diversification*** in terms of risk factors, markets, and instruments. This process is ***favouring*** the ***privatisation and*** the ***enlargement of equity market capitalisation,*** which still fails to represent appropriately the size of the European economy in relation to that of the US (Fig.4, quoted).

Moreover, ***the boost of funds under management will help the transition toward a single bond and equity market***, since professional ***fund managers*** will be ***much quicker*** than households ***to adjust to*** the ***new "domestic market boundary";*** the convergence process has indeed already increased the correlation of European assets over the last few years.

The birth of the Euro is prompting European financial markets, driven by expectations, ***to behave as*** if they were ***a single Euro-denominated market***; it has also ***created a region whose population, GDP and total financial assets are comparable to those of the US*** (Fig.4, quoted)**.**

However, the ***capital structure of European companies differs fundamentally from that of their US counterparts;*** the former, in fact, still rely disproportionately on banks for finance**.**

At present, about ***62%*** of continental European companies ***financing comes from banks*** and ***only 38% from capital markets***. In the ***United States***, by contrast, this ***proportion*** is ***reversed*****: *only 29%*** of companies' financing comes ***from banks*** (Fig.9)**.**

The introduction of the Euro offers an opportunity to change that, creating a single, liquid capital market that might rival the US one. The ***securitisation of companies' debt*** will ***attract huge flows of savings*** into private capital markets; financial institutions and households' portfolios will shift towards a new pan-European benchmark.
The ensuing ***changes in the capital structure*** of European companies ***will alter the complexion and the workings of European financial systems*** from their typically bank-oriented forms to ***Anglo Saxon type of capital allocation mechanisms*** (Fig.10).

❒ THE ITALIAN PRIVATISATION PROCESS IN A EUROPEAN PERSPECTIVE AND THE ROLE OF IRI

❖ *The international setting*

◗ ***A new role for the State.*** In the ***1980s*** and ***1990s***, a ***major process redefining the role of the State*** has been under way in many countries, particularly in the five major European ones. ***France, Germany, Italy, Spain and the United Kingdom have all experienced*** – although to various degrees – a substantial ***retreat of the direct presence of the State from the economy***.

Privatisation has been a ***key component*** of this process, but by no means the only one; ***deregulation*** of markets ***and*** the increasing ***globalisation*** of world economies have, in fact, proved ***equally important*** in forging the new role of the State and determining the extent of its presence in the economic system.

In Europe, the ***interaction between the processes of globalisation, deregulation and privatisation*** has been ***particularly intense*** in the last decade and is ***virtually changing*** not only the ***economic and financial landscape***, but also the very ***social fabric*** of the countries involved.

In Italy – where the ***spectrum*** of ***Public Enterprises*** is ***broad and highly differentiated***, and still accounts for a sizeable share of Gross National Product and total employment – ***the role of privatisation and deregulation,*** as instruments used ***to redesign the role of the State*** in an increasingly global economy, ***has been of paramount importance and will be a major shaping factor for many years to come***.

In general, in Continental Europe, the ***simultaneous unfolding of the two processes*** and their coordination is proving ***particularly challenging for policy makers***, especially in the ***area of public utilities*** where, very often, competition has been ***"conspicuous by its absence".***

Throughout the 80s and the 90s, ***deregulation has*** indeed ***played*** a ***major role in fostering greater competition and efficiency***, especially in the services' sectors (in particular air transport and public utilities services). In all these sectors, the introduction of a higher degree of market competition has been possible thanks to ***unprecedented advances in technological progress***, which have ***created*** the ***conditions to*** progressively ***dismantle*** the ***natural monopolies.***

In the Telecommunication industry, for example, the very ***possibility*** offered to new potential competitors ***to interconnect*** to the fixed network of the former monopolist has enormously ***increased*** the scope for ***market competition***. In fact, new companies who want to enter the business do not have to freeze an enormous amount of financial resources, to create from scratch their own fixed telephone network; this, in itself, would already constitute a formidable barrier to entry.

Instead, the new competitors can use those resources to build up an agile, more skilled and efficient organisational structure, with regard to strategic marketing, distribution and new product development; in many European countries they have already done it.

Broadly speaking, the ***dismantling of domestic monopolies*** in the area of public utilities has ***already started in all major European countries***, in particular in the TLC segment; it is, ***by its very nature, a long-term goal*** to pursue and ***a complex one***. Its achievement, however, is expected to pay lavish dividends to consumers and new producers, alike.

In Italy, the large number ***of new licences granted*** to mobile phone operators (*Omnitel, Wind and Blutel*) and to fixed phone network (*Infostrada, Albacom, Wind and Tìscali,* to mention the most important) ***bears witness to the irreversible nature of this trend*** (Fig.11-12); ***it also emphasises the key instrumental role played by deregulation*** in stimulating competition, especially in the TLC industry.

This new, ***more liberal***, government ***attitude***, will, most likely, ***pave the way to the adoption of similar measures in other areas of public utilities services*** (electricity, and gas transmission/distribution are likely to be the most important areas in the Government agenda).

❖ ***Key-features of the Italian privatisation process.***

◗ ***Privatisation models. In Europe*** the ***prevailing models*** were essentially ***two***: the ***public company*** one, of English origin, and the so called ***"noyau dur" model*** pioneered by the French government. The ***Italian model***, whose characteristic features are a mix of the British and French models, ***came into play much later.***

Each model sought to exploit the ***comparative advantage*** of the national economic and financial systems and to comply with the different set of ***political preferences*** that the privatisation process was bound to satisfy in each country. In the UK, for example, priority was given to the creation of ***widespread share ownership***, whereas in France top priority was assigned to the twofold objective of conferring ***stability to corporate governance*** and retaining ***national control*** of the privatised companies, through the creation of a ***hard core*** of national shareholders (especially in the so called "strategic sectors"); ***in Italy*** the government tried to pursue both goals simultaneously through the adoption of a ***"mixed model"***.

In Italy, the privatisation process has now reached ***a major turning point***: the age of *"easy privatisations"* (mainly those of industrial and financial companies) is nearly over. By contrast, with the privatisation of Telecom Italia, ***a new era has begun***; we are now being ***faced*** with the ***more challenging task*** of privatising ***public utilities*** or ***companies*** operating in the high-tech segment of industry which – through mergers and acquisitions, alliances and joint ventures – ***seek to reposition themselves*** in a more competitive and global world market.
Their aim is ***to acquire*** the needed ***size and core competencies*** that will eventually enable them ***to grow from domestic to major world or regional players.***

Telecom Italia – whose market position has already felt the effects of the ongoing deregulation process –, ***ENI*** (whose majority stake is already in the market, following the placement of the fourth tranche), ***ENEL*** (still entirely public but subject to stringent deregulation

measures which are starting to erode its dominant position), ***Alitalia*** (53% the public sector stake) and many of the ***Finmeccanica*** (61% still in public hands) companies operating in the aerospace, defence, power generation and transport sectors, constitute ***highly representative examples*** of these two major categories (*public utilities* and *hi-tech manufacturing*). They give us not only a genuine taste for the difficulties and the risks, but also for the opportunities that lie ahead, as we move towards a successful completion of the privatisation process.

The ***efforts*** of recent years ***to speed up the process*** of privatisations and make it irreversible have already ***produced highly significant results***. In the *European Privatisations' League*, ***Italy has firmly established itself in second place*** – in terms of global proceeds (public offers plus private sales) – after the UK, but well before France, Germany and Spain (Fig.13a). If we restrict the analysis to the ***1992-1998 period, Italy gains by far the top place*** (Fig.13b).

❖ ***Privatisation in Italy: a retrospective view.***

◗ ***Conditions of the Italian economy at the start of the process. Italy*** is, in many respects, ***a late-comer*** to the process of privatisation ***but***, by all means, ***a fast catch-upper.***

Right from the start, Italy presented ***an almost unique set of favourable conditions*** for a wide-ranging privatisation programme. These were:

- the presence of ***a large number of state-controlled enterprises***, accounting for a substantial share of *total added value* generated by the economy;
- ***attractive flotation prices,*** due mainly to the *bear stock market* conditions prevailing at the start of the process (end of 1992);
- ***ample margins for improving*** the ***efficiency*** and ***profitability*** of the newly privatised companies.

The Government announced its plan to sell-off many of the state-owned companies on January 29th, 1992, but the programme for ***the actual sale*** of publicly owned enterprises ***began*** only ***in 1993***. Privatisations have helped sustain the markets' confidence in the Government's efforts to correct the problem of mounting public debt. They have also fostered greater efficiency both in the stock exchange and within the newly privatised companies themselves.

◗ ***The modernisation of the Italian regulatory framework.*** The ***compelling need to create*** the most ***suitable conditions*** to implement successfully such an ambitious privatisation programme ***called for*** the ***adoption of new legislation*** that established the legal framework within which the process was to be carried out.

One of the first and ***most important measures*** adopted ***was the transformation of the four main State Holding Companies***: ***ENEL*** (electricity), ***ENI*** (petrochemical), ***INA*** (insurance) and ***IRI*** (a holding company controlling at that time industrial as well as banking conglomerates) ***were all transformed*** from state-controlled agencies ***into public limited companies (Law 359/1992).*** This was done in order to ***create,*** wherever possible, the ***conditions "to go public"*** and to ***make them subject to the provisions of civil law.***

Later on, the Italian Parliament approved ***two other important laws – Law 474/1994*** and ***Law 481/1995 –*** that ***completed the legislative mosaic***, ***giving birth to a modern and rather sophisticated regulatory framework;*** Law ***474*** introduced, among other things, the ***"golden share",*** whereas Law ***481*** laid the ground for establishing the so called "***sèctoral Authorities***" in the areas of public utilities (Fig.14). With regard to the golden share, a Government decree of last May has limited the extent of its use to a very restricted number of the so-called "strategic" sectors and for very limited "public interest" reasons, very much in line with the proposals of the European Commission.

The upgrading of the legislative framework was of paramount importance for the privatisation of large companies such as ***INA*** and ***ENI, and*** for that of ***public utilities***. Thanks to them and also to declining interest rates and measures such as the suspension of *capital gains tax* (reintroduced as of July 1st, 1998), it was possible to ***widen the set of investment options in the equity-segment*** of the financial market. ***That encouraged*** both ***a process of assets' reallocation*** within investors' portfolios – away from fixed-income government bonds and towards equity assets – ***and a wider share ownership***; two ***outcomes*** which ***ranked high*** among the goals of policy makers.

◗ ***The constraints and the birth of the Italian mixed model.*** The set of favourable conditions existing at the outset of the Italian privatisation process were coupled, however, with ***a number of constraints*** that made the sheer adoption of either the British model of the public company or the French one of the noyau dur, quite difficult to contemplate.

In fact, policy makers were quite reluctant to adopt the ***British model***, not only for the relatively ***small size of the Italian stock market*** – an important constraint in itself – but also, and above all, for the ***inadequate presence of domestic institutional investors*** (pension funds, in particular) that characterised the Italian financial market. This latter element carried with it substantial risks of ***corporate governance instability***.

They were also fully aware of the difficulties arising from the possible adoption of the ***French model*****;** if anything, because Italy ***lacked the large number of private entrepreneurs or private companies needed*** to feed and sustain a large scale privatisation programme such as the one implied by the vast dimension of the Italian public sector**.**

It was the desire ***to remove the impact of those constraints*** on the Italian privatisation process, that eventually led to ***the adoption of a*** pragmatic "***mixed" model***, capable of effectively ***blending the most typical features of the British and French models***.

The Italian model, in fact, envisages the ***simultaneous use*** of the instruments of ***public offer*** and a ***core of stable shareholders*** (usually between 10 and 30% of the company's capital). In the case of public utilities, the presence of sectoral Authorities plays a major regulatory role. On a selective basis, contemplated by ***law*** (***474/94***), the ***golden share*** is also adopted, similar to the British one and to the "action spécifique" of the French model. This latter instrument is aimed, among other things, at ***preventing any hostile take-over*** but above all at ***clearing the way*** to the market ***placement of the whole public stake***; as mentioned before, however, the extent of its use has been significantly restricted by the EU Commission.

On a more general level, in the ***European privatisation process*** the following elements stand out:

- ***the UK*** – the only big European country capable of adopting the pure public company model, thanks to a highly sophisticated and articulated financial market – has almost completed its privatisation process and is therefore ***bound to play only a marginal role*** in the foreseeable future;
- ***in most European countries*** – where privatisation still has a long way to go due to the presence of a still vast public sector (France, Germany, Italy and Spain to mention the most important ones) – ***the conditions of the economies and of financial markets seem to be more conducive to the adoption of a mixed model,*** rather than to that of the pure public company model.

The ***Italian and French models***, therefore, ***seem to be emerging as the embryos of a truly European model***. In fact, ***in the more mature phase of the European privatisation process*** the introduction in the French model of some of the typical features of the British model has markedly ***increased*** the ***degree of convergence of the two models; witness to that,*** the increasing use of the instrument of public offer recorded in the later stage of the French privatisation process and the more open attitude of the Balladur Government towards the presence of foreign capital in the equity base of the newly privatised companies (Fig.15a-15b).

The truly ***European nature*** of the Italian model ***and*** its ***effectiveness*** is ***evident***, ***not only for the similarity*** of the prevailing economic and financial conditions of most European countries who have embarked on large scale privatisation programmes, ***but also for the solid reputation*** it has earned – ***thanks to an impressive performance – and for the dramatic improvements*** it has brought about in the Italian economy at large.

In fact***,*** it has effectively supported one of the largest privatisation programmes in Europe, with ***global proceeds*** of more than ***79 billion dollars,*** since the start of the process in 1992; it has greatly contributed to the emergence of a more ***modern regulatory framework*** and to the ***deepening and widening of*** the Italian ***stock market***; it has ***fostered*** the birth of a ***modern*** system of ***corporate governance*** and a ***higher*** degree of ***market competition***.

For all these reasons, it would be ***too simplistic to regard privatisation*** as being essentially ***a financial phenomenon***, whose benefits are only confined to financial markets in terms of higher

efficiency and growth. If we did it, ***we would lose sight of the enormous impact*** that privatisations have had throughout their implementation ***on*** the ***real economy***.

In fact, in the 80s and 90s ***privatisations*** have acted as a very ***powerful stimulant to the process of globalisation of enterprises***. They paved the way to a rapid process of ***innovation*** with regard to organisational structures and strategies, managerial styles, market strategies and, above all, speed and efficiency of the decision-making process.

The ***consolidation of*** these ***results*** and the possibility of further progress ***rests on the creation*** of a ***large base of institutional investors*** capable of permanently monitoring company ownership and top management performance. ***In this respect***, the rapid ***growth of pension funds*** in Italy is, indeed, ***a crucial prerequisite*** but needs ***to be complemented with the*** full ***support of foreign institutional investors***[1]**.**

❖ ***The impact of privatisations on the Italian Stock Market***

The impact of privatisations ***on the*** Italian ***stock market has been quite impressive***. Over the period ***December 1992 / August 1999*** – which marks a rising and accelerating trend in privatisation operations – ***stock market capitalisation rose from 116 billion dollars to almost 586 billion dollars*** (over ***5.1 times*** the original amount); ***as a percentage of GDP***, capitalisation rose ***from 11.2% to 50.3%*** (nearly ***4.5 times*** the original figure). Over the same period, the ***COMIT stock market price index rose from 451 to 1507*** (***3.3 times*** the original level) (Fig.16a). The ***market ROE***, itself***, increased markedly (from 4.6%*** in 1992, ***to 7.7%*** in 1998) and is ***expected to reach almost 9% in 1999***, while ***the spread ROE-long term interest rate*** swung, on average, ***from – 6.6% to + 4%*** (Fig.17).

These ***remarkable achievements*** on the stock market front were ***made possible not only by the extraordinary turnaround of economic conditions*** – in terms of healthier public finances, lower inflation and interest rates, unprecedented current account surpluses, stable currency and

[1] ***For a chronology of Italian privatisation operations (1992/1999) see BOX 1***

improved picture on expected returns – ***but also by the accompanying improvement of the investment climate***, brought about by the outstanding progress made on the privatisation front.
In fact, over the period mentioned before, the ***contribution of privatisation operations to*** the ***growth of the Italian stock market*** has been highly significant and ***close to 52%*** of ***1993*** market ***capitalisation*** (*at 1998 prices*) ***and***, roughly, ***10%*** of the ***present*** market ***capitalisation*** (Fig.16b).

With regard to that, ***the role of IRI has been quite outstanding,*** not only in ***quantitative*** terms but also in ***qualitative*** ones**;** over the period (1992-98), IRI's placements have equalled almost ***21%*** of ***1993*** market ***capitalisation*** (*at 1998 prices*) and, roughly, ***4%*** of the ***present*** market capitalisation; moreover ***a number of high quality IRI's stocks*** *has* ***entered the MIB30 basket*** (Alitalia and Finmeccanica, still in our portfolio; Telecom Italia and TIM, today private companies, but previously owned by IRI; the recent new entry Autostrade spa).
However, ***in spite of this remarkable progress***, the ***size of the Italian stock market*** – in terms of capitalisation-to-**GDP** ratio – is ***still relatively small***, compared to that of the most developed stock markets; it is presently over **37*%,*** well below the record levels of the UK (***155%***) and USA (***113%***), but also below those of Spain (***61%),*** France (***57%)***, Japan (***56%)*** and Germany (***44%). In value terms the Italian market ranks 9th among the major world stock markets*** (Fig.18a); this comparative disadvantage is evident also with regard to daily stock market turnover (Fig.18b), in spite of the remarkable progress made by the Italian stock market in the last few years (Fig.18c).

In my opinion, however, ***official*** stock market ***statistics grossly overstate the real dimension of this gap, due to the massive presence of unlisted small and medium size enterprises*** that characterises the Italian economy. This peculiarity of the Italian enterprise system ***makes any cross-country comparison highly misleading***, and should lead us to a much ***more cautious assessment of the real equity base*** of the economy; ***the latter is*** in fact, by all means, ***much larger than that accounted for by official statistics.***

If brought to surface, this large, and ***unexploited, "equity reservoir" could*** substantially ***contribute to the widening and deepening of the Italian stock market,*** to the benefit of domestic as well as foreign investors. ***The existing gap*** of capitalisation ***would,*** most likely***, be greatly reduced,***

making any cross-country comparison more homogeneous. This ***opinion*** seems to be widely ***shared by Consob*** (the Italian equivalent of FSA and SEC), as it emerges from its last *Annual Report*. It is estimated that the ***number of potentially listable*** companies is ***close to 500 units***, with a ***potential*** of ***additional capitalisation*** of at least ***106 billion dollars*** (Fig.16b quoted).

Therefore, the most appropriate "***ways and means" to bring this vast hidden resource to the market*** (through, for example, the equivalent of ***Nasdaq*** or ***Easdaq*** markets) should be ***carefully considered and assessed***, if we want to attract an increasing number of investors to the Italian stock market**;** the recent birth of the so-called ***"new market"*** goes in this direction and tends to attract small and medium enterprises towards "listing"**.**

The ensuing removal of any existing equity capital shortage ***would not only generate a more balanced capital structure*** for those firms, ***but also fuel***, through a multiplier process, ***a more robust growth of small and medium size enterprises, starting a virtuous circle*** that would eventually feedback into the growth process of financial markets.

❖ ***IRI's Contribution to the Italian Privatisation Process***

In the Italian privatisation process ***IRI*** has played a major role; its ***contribution*** has been ***highly significant***, both ***in quantitative as well as qualitative*** terms**. *Over the period 1992-98, IRI*** has carried out a ***large-scale privatisation*** programme ***with proceeds reaching 31.8 billion dollars*** (at 1998 prices), i.e. ***40***% of the national total (Fig.19).

The ***IRI holding*** has provided ***the greatest contribution*** to the Italian privatisation process, accounting for ***nearly 22.9 billion dollars*** of revenue raised***. IRI's subholdings,*** however, together with their subsidiaries have ***also played a major role*** in supporting the large scale privatisation programme launched in 1992, ***raising a total of almost 9 billion dollars***. Altogether a total debt of about ***11 billion dollars*** was ***simultaneously transferred*** to the new private owners, bringing the ***global amount*** of resources ***mobilised*** over ***43 billion dollars*** (Fig.20-21).

The whole privatisation programme extended over a wide range of sectors ***involving more than*** 650 companies***;*** in a five-year time span, IRI completely abandoned ***the sectors of***

banking, steel production, telecommunications, food processing and retailing, refreshment and restaurant facilities**.**

This process stimulated the emergence of new entrepreneurs, ***opened up*** new ***sectors to*** competition, ***increased the*** confidence ***of*** foreign investors, widening ***and deepening, at the same time,*** the domestic capital market.

IRI has been at the forefront even ***with regard to the qualitative aspects*** of the process, especially in terms of:

- ***privatisation strategy***; as a policy, ***minority stakes*** were ***retained only for a limited period of time***, where that was instrumentally necessary to complete the operation in various tranches;
- ***transparency of procedures*** adopted in each operation;
- ***efficiency and complexity of restructuring measures*** undertaken ***prior to privatisation***;
- ***variety and complexity of techniques used*** (break-ups, *mixed* public offers, private sales). Very often a *tailor-made mix* has been used, in order to maximise the value of the divested assets. During the whole privatisation process, however, the mix of public offers and private sales has proved to be quite well balanced (58% of public offers; 42% of private sales);
- ***existence of clauses to safeguard the level of employment and the growth perspectives*** of divested companies, ***in the aftermath of privatisation***.

The underlying ***managerial philosophy*** was not only ***aimed at*** actively managing the portfolio of assets, but also at ***creating value through*** the most appropriate strategic ***repositioning*** of the companies targeted for privatisation.

All that was considered right from the start of the privatisation process, clearly bearing in mind that the fate of the company was a social value to defend and in spite of the financial difficulties IRI was going through. ***This was IRI's goal in the past; this will also be the mission of IRI during the time span remaining to the end of the present mandate.***

Among the most representative examples that bear witness to this managerial philosophy, the following deserve special mention:

- ***the break-up of SME*** and the subsequent spin-off of the various sectors (food processing, retail distribution, refreshment);

- ***the successful restructuring of Italimpianti*** *(plant engineering)* ***and Ilva*** *(steel production*), both of which operated in highly competitive and cyclical sectors, plagued, in the case of steel, by overcapacity;
- ***the equally successful reorganisation of the telecommunication sector within Telecom Italia***, through a series of mergers that eventually gave birth to the figure of the ***"single provider"*** and the subsequent spin off of the *mobile-phone* segment with the creation of ***TIM***.

The implementation of all these measures – which were profoundly ***innovative for the Italian industrial landscape*** – enabled IRI to acquire ***new and more advanced competencies*** in the areas of organisation, restructuring and strategic planning. This will prove to be, by all means, a very precious asset in order to tackle successfully the privatisation of ***some of the most complex industrial realities*** in the ***high-tech segments*** of defence, aerospace, civil aviation manufacturing and transportation, that are still in our portfolio.
The privatisation of these companies will, most likely, call for an extensive use of this know-how as we approach the daunting task of entirely revising the map of presence in all these sectors.

On a more general level, the present strategy of privatisation has**:**
a) greatly improved the decision-making process of companies, making it ***more reactive and more efficient***. This result is particularly important in the present complex business environment where ***time***, itself, has become a ***"key-variable" to compete*** successfully;
b) profoundly changed the economic and business landscape, leveraging the set of strategic options available to our companies; the cases of Alitalia (with KLM) and of some of Finmeccanica's companies (with Westland, Bell, GEC-Marconi and ABB) bear witness to that.

❖ ***Impact of privatisations on the economic and financial conditions of IRI***.
The ***strategy pursued*** in the last five years with regard to restructuring and reorganisation measures, together with the rapid unfolding of the privatisation process has ***paid out remarkable dividends***.

Already ***in 1996 IRI Spa*** was ***back in the black*** (with ***119 million dollars*** of ***net profit***), after seven years of consecutive losses. This marked a major turning point in IRI's accounts, that recorded a ***record profit*** of nearly ***3 billion dollars in 1997 and of 1.8 in 1998;*** in those years ***IRI paid, for the first time ever, lavish dividends*** (***1.6 billion dollars and 1.7, respectively***) ***to the Italian Treasury***, its shareholder**.**

The 1997 and 1998 positive net income figures – although positively affected by the extraordinary revenue item linked to the sale of Telecom Italia – confirm that the ***restoration of healthy operational conditions*** is ***here to stay, as witnessed by the positive trend recorded in operating income*** (Fig.22) (net of extraordinary items)**.**
Moreover, coupled with the improvement in net income – and reinforcing this trend – there has been an even more ***significant improvement of IRI's financial position***. The ***heavy financial debt*** which has plagued IRI's accounts for many years, has ***virtually*** been ***wiped out;*** the ***"zero debt" target*** was successfully ***hit in 1997;*** as a result, since the end of 1997, ***the net financial position*** of ***IRI Holding has turned positive***.

The IRI Holding, therefore, ***is not just selling its companies. It is,*** simultaneously, ***creating value through*** sophisticated ***restructuring*** strategies, a ***sound managerial conduct and*** the most ***appropriate strategic repositioning*** of the companies targeted for privatisation. ***The firm establishment of sound*** economic and financial ***bears witness*** to the ***non-transitory nature of the recovery*** process**.**

In spite of the ***large-scale privatisation*** programme already implemented – which, over the period 1992/1998, has ***substantially reduced*** IRI's ***business portfolio – we still rank as the fifth industrial group*** in Italy, in terms of turnover.
This ***remarkable presence*** in the Italian economy is ***spread across a wide range of sectors:*** defence, aerospace, power plants engineering and industrial automation (Finmeccanica); broadcasting (Rai); infrastructure and construction (Fintecna); shipbuilding (Fincantieri); semiconductors (ST Microelectronics); and financial services (Cofiri).
We are still ***majority shareholders*** of Alitalia (air transport), Finmare (maritime transport), Aeroporti di Roma (airport infrastructures) and Autostrade (toll motorways network).

However, ***in all these sectors our goal remains 100% privatisation by*** the end of the present mandate (***June 2000*****;** two major privatisation operations in the pipeline, ***Aeroporti di Roma and Autostrade*** (the toll highways network), ***have attracted a huge number of potential buyers*** (Fig.23), ***proving both the effectiveness of the mixed model approach and our commitment*** and determination to "finish the job" on schedule.

❒ OLIVETTI'S TAKE-OVER OF TELECOM ITALIA: A CASE-STUDY ON THE EMERGING MARKET FOR CORPORATE CONTROL AND ON CORPORATE GOVERNANCE ISSUES

The case-study presented is, in my opinion, of particular ***relevance with regard to*** the possibility of establishing in Italy ***a contestable market for corporate control*** and of fostering a ***greater efficiency in the corporate governance process*** of privatised companies.

It is ***relevant for the following reasons***:

- ***It is the first time that a hostile take-over*** - a typical instrument of Anglo-Saxon capitalism - is ***used in the Italian financial market***, after the July 1998 introduction of the so-called *"Legge Draghi"*, a new regulatory framework which governs the workings of the Italian financial market;
- it is ***the first time,*** ever since the adoption of the mixed model**,** that a ***newly privatised*** Italian company is ***taken over shortly after privatisation***, altering the initial composition of the Core Group of Stable Shareholders (CGSS) set up by the Government;
- ***it highlights the strengths and weaknesses of the Italian "mixed model" and the functioning of the so-called Core Group of Stable Shareholders (CGSS)***; some important ***issues of both internal and external corporate governance***; the extent to which ***the "size" factor*** matters ***with regard to*** the ***efficiency*** of the corporate governance process ***and*** the degree of ***contendibility*** of the company;

- ***it shows how the financial market*** as a whole ***reacted*** to the take-over under scrutiny and ***the role played by Italian and foreign institutional investors***; it also emphasises ***the role played by the banks*** which have promoted and arranged the deal;
- ***it confirms the significant potential of the new Euro-financial environment*** in terms of innovation and size, ***as witnessed by the fast growing Euro-denominated market for corporate bonds;***
- ***it signals the birth of an Italian (but also of a pan-European) market for corporate control, made possible by the development of a single Euro-denominated financial market in Euroland.***

Only ***few years ago***, ***the take-over of Telecom Italia*** would have been ***unthinkable*** because of insufficient width and depth of financial markets: ***it was the extraordinary rise of the Euro-denominated corporate bond market and the underlying Euro-syndicated loan market that made the inconceivable come through.***

❖ ***The Privatisation of Telecom Italia***

Telecom Italia***, which has been a joint stock company for several years, is Italy's largest telecommunication company. As we shall see shortly, it*** was born out of IRI's rationalisation process of the Italian TLC sector ***which took place in the mid-nineties. Telecom Italia owns, among other things,*** TIM (Telecom Italia Mobile), the number one European mobile phone operator ***(Fig.24).***

With net sales of 26.2 billion dollars and net income of 2.2 billion dollars***, Telecom Italia is one of the largest TLC company in Europe (Fig.25).***

Telecom Italia ***was formed in 1994 by merging 4 major Italian TLC companies*** (***SIP***, fixed network continental operator**;** ***Italcable***, fixed network intercontinental operator, ***Sirm,*** naval communications and ***Telespazio***, satellite TLC) ***into one company***.

Until the end of 1996 Telecom Italia was controlled by STET, a financial holding company, with a stake of 62.5% of share capital and the rest floated on the market; STET, in turn, was controlled by IRI who owned 64% of share capital; the rest was floated on the market.

In December 1996 both stakes were transferred to the Ministry of Treasury and ***in the summer of 1997 STET and Telecom Italia were merged into the new Telecom Italia,*** a company listed in the stock market. Shortly after the Government began the process of privatisation. In fact, on the 4th of October 1997, the Ministry of Treasury announced his intention to sell its 44.7% stake in Telecom Italia valued at 22.9 billion Lira (13.4 billion dollars). ***It was the largest single privatisation operation ever carried out in Europe.***

At a broader level, ***with the privatisation of Telecom Italia, the Government forged the general pattern that would later be followed for the privatisation of all other large public utilities***. More precisely, ***two major long-term goals were set***:

1. ***to create, at the end of the process, Italy's first public company;***
2. ***to foster the birth of a true market for corporate control.***

Such goals reflected the ***basic philosophy*** adopted by the Government right from the start of the privatisation process, in 1992, which translates into a concept of ***Italian capitalism that gradually but steadily moves towards an Anglo-Saxon type of system***; that is, a system with a broader and deeper stock market, where institutional investors play a major role, with a few large public companies and an efficient market for corporate control to monitor the performance of management.

Since this is a long term goal, ***the transition to that runs through what we have called the "mixed model"***; i.e., the creation of companies controlled by ***core groups of stable shareholders*** (mainly financial institutions) and with the remaining capital base floating on the market.

In fact, the structural constraints ***mentioned before, that characterised the Italian economy,*** made the sheer adoption of either the British model of the public company or the French one of the noyau dur, quite difficult to contemplate. To overcome these constraints, the Italian model ***was conceived in a way that*** envisaged the simultaneous adoption of the instruments of public offer and the Core Group of Stable Shareholders ***(usually between 10 and 30% of the company's capital);*** and this is exactly what happened with the privatisation of Telecom Italia. ***A Core Group of Stable Shareholders was formed equivalent to 6.6% of share capital*** (Fig.26) ***and a public offering was launched, equivalent to 32.9% of share capital.***

The demand for shares stemming from the public was "enthusiastic", with 3.9 million shares demanded (against 1.7 million offered); and that created, at the end process, 450,000 new shareholders. Institutional investors joined in with 280,000 shares, of which 190,000 were acquired by foreign investors. It is important to mention that ***at the moment of the tender offer made by Olivetti***, a year and a half after privatisation, ***foreign investors*** (mainly US funds) had raised their stake to ***53%*** of Telecom Italia's equity base (Fig.27).

❖ ***Post-privatisation Corporate Governance Issues***

The private placement was equivalent to 3,900 bn Lira (2.3 bn dollars), ***one of the largest private placements ever done***. The ***goal*** of the Italian Government was ***"to create a Core Group of Stable Shareholders large enough to assure stability of control, with a plurality of actors and no dominant position"***.

The Ministry of Treasury at the moment of the creation of a Core Group of Stable Shareholders (CGSS) asked that those members with less than 1% of share capital (*conditio sine qua non* to get one seat in the Board) should form alliances to reach the threshold value of 1% set by the Treasury**;** as a result four alliances were formed, mainly among banks and insurance companies.

The Treasury also demanded that all the ***members of the Core Group*** of Stable Shareholders ***should agree not to sell their stakes for a period of at least 3 years*** to guarantee stability of control.

The privatisation brought into the company a ***large majority of private capital*** representation on the Board and ***private managerial methods and styles***.

Another key element arising from the relative small size of the Core Group of Stable Shareholders, and, above all, from the rapid growth and development of financial markets – today much more sophisticated than they used to be at the beginning of the privatisation process – ***is the increased degree of contendibility*** fostered by the new financial environment ***which has given birth to a real contestable market for corporate control***.

I do believe that ***contendibility*** of a company ***is an asset*** rather than a liability, ***if maintained within physiological levels*** that make it a source of efficiency; ***by contrast, if pushed beyond a***

critical threshold it can become highly disruptive to the process of corporate governance, as it becomes a source of instability (Fig.28).

❖ ***Olivetti's take-over of Telecom Italia***

On February 20th, 1999, Olivetti launches a Public Tender offer for 100% of Telecom Italia's share capital and exactly ***3 months later wins the bid obtaining 51.02%*** of Telecom Italia' share capital ***and total control of the company*** (Fig.29).

The tender offer was financed with the following instruments (Fig.30):

- a secured loan of 6.5 bn Euro;
- the issue of 7.9 bn Euro Tecnost International Notes;
- Olivetti capital increase of 2.6 bn Euro.

The take-over represents, from a structural point of view, ***the first, strong, empirical evidence that we are experiencing a major change in the evolution of the Italian financial system***; ***the recent attempt by Assicurazioni Generali*** (the largest Italian Insurance Group) ***to take over INA***, its largest competitor in Italy, ***confirms the existence of a physiological level of contendibility and the correlated birth of a market for corporate control,*** in a system where both were previously conspicuous by their absence; it also proves the point that Anglo-Saxon models of capitalism in Italy can work; better if adapted to the indigenous environment.

At a more general level, the sheer size of the deal***, which makes it both*** the largest ever syndicated loan financing ***in Europe and*** the largest ever corporate bond offering***,*** is also evidence that the Euro-zone***, with the introduction of the Euro as a common currency,*** is developing large, deep and highly integrated capital markets.

Much of it has to do, as we already pointed out, with the downward trend of benchmark interest rates which, on the one hand, renders bank loans' rates much more attractive and, on the other hand, it fosters the growth of a European corporate bond market similar to that of the US.

In conclusion, ***the tender offer was made possible by a number of changes*** which have been taking place in the last few years in European capital markets. Herewith is ***a summary of the most relevant ones:***

- the ***launch of the Euro*** as a common currency and ***the creation of a single***, highly integrated, ***European capital market***;
- the ***development of a Euro-denominated corporate bond market;***
- the ***fall of benchmark interest rates***;
- the ***extraordinary rise of the European fund management*** industry which has fuelled the development of financial markets;
- the ***growing sophistication of European institutional investors***;
- the ***growing presence of American funds*** in European financial markets;
- the ***growing use of indexed financial products*** by European capital market players.

The tender offer had also some major ***consequences on the awareness of policy makers and companies' managers*** of the consequences stemming from the creation of a new Euro-environment, with regard to:

- ***developing the use of leverage financing*** and ***more sophisticated financial instruments*** by European corporate;
- ***enjoying the new opportunities*** and ***learning how to cope with the new risks*** created by a large and deep market of corporate bonds;
- ***moving debt capital from traditional bank loans to capital markets instruments*** such as corporate bonds, international syndicated loans and equity;
- ***increasing the attention toward corporate governance mechanisms***, both at the level of firms and at the level of national systems;
- ***enjoying the new opportunities*** and ***learning how to cope with the new risks*** stemming from the ***higher degree of contestability of the European market for corporate control***.

❒ CONCLUDING REMARKS

The creation of a financial EURO zone is ***bound to increase the set of strategic options*** open to ***transnational companies***, not only in the financial domain but also in that of the real economy.

In the financial domain, companies will have ***wider funding possibilities*** – thanks to ***wider and deeper corporate bond and equity markets*** and the virtual ***disappearance of foreign exchange risk*** – that will enable them ***to move their present capital structure to a mix*** closer to the one ***they regard*** as being ***optimal***.

In the real economy's domain, these ***better funding*** opportunities coupled with ***increasing globalisation, privatisation and liberalisation of European companies and markets,*** will also ***enable firms to rationalise*** more quickly and ***effectively their geographic and sectoral map of presence***; ***mergers, acquisitions and global alliances*** will become the ***most important drivers of the strategic repositioning processes*** of those firms.

In Italy, ***EMU*** is expected to have ***a relevant impact*** not only on financial markets, but ***on the whole of the Italian economy***. The ***Euro's effects, in fact,*** will soon filter through the real economy, as a result of the ***strong reallocation of investments by pension funds and institutional investors*** expected from ***non-EMU*** to ***EMU countries'*** stock markets.

Such ***flows*** will be mainly ***channelled into France, Germany and***, to a lesser extent, into ***Italy***. As far as our country is concerned, ***estimates*** remain nevertheless quite ***impressive***, exceeding ***300 billion dollars***.

The investment ***allocation criteria***, however, ***will*** most likely ***follow*** a ***sector based rather than*** a ***country based logic*** since new capital will be directed to companies pursuing ***value-maximisation strategies*****;** competitive mechanisms and relative market sanctions will be strengthened.

With regard to ***privatisation***, the process is ***expected to continue throughout Europe***, if financial markets conditions do not deteriorate further, because of the regional crisis (Asia, Latin America, Russia and Japan).

In Italy, in particular, the government appears to be very determined to take to completion the privatisation ***programme launched in 1992 and*** to fully ***exploit*** the ***wider set of options*** generated by privatisations.

At this stage of the programme, the ***key task*** to be accomplished is the ***steering of the strategic repositioning of the Italian industry***, ***in a market*** that today is not only much ***more global and more conducive to international alliances***, but also much more ***selective and riskier*** than it was at the beginning of the '90s.

The strategic repositioning exercise, in particular, seems to be quite a complex and challenging one, especially in the aerospace and defence sectors.

It is widely recognised that the privatisation program has ***played a major role for the entry of Italy in the European Monetary Union*** and that its completion in the coming years is ***necessary*** to achieve the country's ***full potential of economic growth***.

The performance of the mixed model of privatisation chosen by Italy has ***exceeded*** the most optimistic ***expectations***, with privatisation proceeds reaching almost 80 billion US dollars.

The continuity of the process is out of question. In 1999, in fact, the ***Treasury plans to sell*** the whole holding in ***Mediocredito Centrale (100%)*** and the residual stakes in ***Banco di Napoli (16.3%) and Banco di Sicilia (21%). Diverging opinions*** still ***exist as to*** the full privatisation of ***Eni*** (36,3% still in public hands) and ***Enel*** (100% public).

In the case of Enel, however, ***the first tranche will be placed in the market by the end of this year*** while the current deregulation wave is prompting the sale of some of the existing energy production capacity (about 15%)**.** Finally, ***the reform of the banking foundations***, together with the accelerating consolidation process of the European banking systems, will ***boost*** the process of ***modernisation*** of the ***Italian financial system***.

All these measures bear witness to the ***government's relentless efforts*** and unyielding commitment to ***go rapidly ahead and steer the whole privatisation process to*** a successful ***completion***.

As for IRI, ***there were two major goals*** set at the launch of the privatisation program: ***to restore healthy*** economic and financial ***conditions*** and ***to*** effectively ***address*** the issue of ***strategic***

repositioning. ***The first one*** has already been ***successfully achieved***, whereas the ***experience gained*** in the last five years – in the areas of industrial and financial restructuring and in the reorganisation of the decision-making process machinery – ***makes us feel very confident about*** our ability to efficiently master the ongoing process of ***the strategic repositioning of our companies***.

According to our ***present mandate***, we plan ***to complete*** the ***privatisation program by June 2000***. The ***financial resources*** generated by the process will be available ***to our shareholder***, the ***Treasury***, for its own strategic priorities.

By then, ***IRI will have accomplished an historical mission with long-lasting benefits for the whole Italian economy.***

BOX 1 – ITALY : A CHRONOLOGY OF PRIVATISATION OPERATIONS (1992/1999)

A privatisation programme of the magnitude and complexity of the one launched in Italy in 1992, requires a reasonably long time span for its completion.

***Prior to 1992**, the country had already experienced few isolated, although important, privatisation operations: **ALFA ROMEO** (Auto) in 1987, **ENIMONT** (Chemicals) in 1989, **CEMENTIR** (cement) and **S. PAOLO BANK** in 1992, totalled an amount exceeding **3 billion dollars**; **IRI**, itself, had **mobilised financial resources** (through sale of companies, real estate and assets, and transfer of debt) **for an amount close** to **14.7 billion dollars** (inclusive of the Alfa Romeo and Cementir sales).*

*The **process**, however, **gained momentum** only **in 1993 (proceeds exceeded the 3 billion dollar figure) and accelerated markedly in 1994 (with proceeds exceeding 8 billion dollars)**. The financial sector (banking and insurance) **got the lion's share** but the steel and food industries also played a very important role; **IMI** (a merchant bank), **INA** (an insurance company) and, within **IRI**, **CREDIT** and **COMIT** (two commercial banks), **AST** (steel) and the **SME** companies (Italgel, Cirio-Bertolli-De Rica, Gs, Autogrill and Atena, in the food processing and retail distribution sectors) were all successfully privatised, paving the way to a consolidation of the whole process.*

***In 1995 and 1996** global **proceeds** from privatisations **levelled off at more than 8 billion dollars** per year. The most important operations carried out during this period were the **last two tranches of INA** (for a total of 3.2 billion dollars) and the **first two tranches of ENI** – a giant conglomerate of oil, energy and chemicals – that alone totalled over 9 billion dollars. Within **IRI**, it is worth mentioning among the most important operations, those of **Ilva Laminati Piani** and **Ilva Servizi Energetici** (spin-offs from the steel parent company), **Dalmine** (steel), **Italimpianti** (plant engineering) and **Alfa Romeo Avio** (aero-engines).*

In 1997 proceeds reached a record high of** nearly **32.6 billion dollars** thanks to three major placements: the **third tranche of ENI**, the **private sale of CARIPLO bank** and the **flotation** of the **majority stake of TELECOM ITALIA** (the national telecommunications company that until recently had enjoyed a virtual monopoly in its business segment). In addition, in the same year, **IRI placed in the

market the first tranche (45%) of Aeroporti di Roma and *completed the privatisation of* ***BANCA DI ROMA****.*

In 1998 global proceeds have totalled over 14 billion dollars. *The most important operations have been the placement of* ***the fourth tranche of ENI*** *(which reduced the public stake below 50%),* ***the third tranche of S.Paolo di Torino*** *(bank)* ***and the privatisation of BNL*** *(bank)* ***and AEM*** *(Milan's electricity utility).* ***Within IRI, ALITALIA's public stake*** *has been* ***reduced*** *further* ***to just above 50%;*** *for the first time ever in Italy, the company has allotted to employees a sizable share of its capital (20% of the equity base). In addition,* ***Elsag Bailey PA****, in the process automation sector, and* ***Italia di Navigazione*** *and* ***Lloyd Triestino****, two major shipping companies, have been* ***entirely privatised.***

In the first months of ***1999*** *the major privatisations have been* ***Monte dei Paschi*** *di Siena (bank) and* ***Acea*** *(Roma's electricity and water utility).* ***IRI*** *has privatised* ***Condotte*** *and* ***Italinpa*** *(PublicWorks&Infrastructures) and* ***Grandi Motori Trieste*** *(naval engines); whereas* ***Aeroporti di Roma*** *and* ***Autostrade*** *(toll highways network) will complete privatisation within the end of the year.*