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ABSTRACT

Dynastic management and historical origins: the Italian experience

In this paper we explore the long run determinants of the emergence of family firms and different types of corporate governance. Using a representative sample of Italian firms, we show that higher current levels of trust, related to the experience of a free commune in the Middle Ages, are negatively related to the probability of being a family firm and to observing a dynastic management. On the contrary, higher level of trust are positively related to the probability of appointing an external manager or an internal manager not belonging to the family dynasty. These results are confirmed by an instrumental variables strategy used to tackle endogeneity issues. Some policy implications are also discussed.

KEYWORDS: family firms, management, governance, cooperation, persistence

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1. Introduction

The presence of family-influenced firms is a common trait in many economies and their role on economic outcomes animate an ongoing debate (Villalonga and Amit 2020). In this vast area of research, the hypothesis that cultural norms contribute to explain the diffusion and performance of family business is a challenging issue, although very few empirical studies have estimated the causal role of long run cultural determinants of presence and distribution of family firms (Xie and Yuan 2021).

The hypothesis that culture and institutions may affect economic results is not new (Bertrand and Schoar 2006; Guiso *et al.* 2006; Alesina and Giuliano 2015). Adopting a cultural approach, Banfield (1958) highlighted a potential trade-off between close family networks and ties in the society at large. He argued that where family centric society arises and 'amoral familyism' prevails, the distrusts on larger networks is one of the main determinants of slower economic growth. Putnam *et al.* (1993) found that regions that have inherited a legacy of civic engagement, showed positive economic results and their divide with other regions persisted over the years, as documented by the sharp economic dualism between northern and southern Italy. Revisiting the Putnam' hypothesis, Guiso *et al.* (2016) documented that an entire population's sense of empowerment has been affected by historical experiences. They showed that Italian Northern cities that recorded a period of independence as free city-states have developed a deep sense of civic and cooperative behavior, transmitted from generation to generation, thanks to self- efficacy mechanisms. In these cases, higher levels of trust and cooperation at local level are persistent traits that are behind higher levels of civil capital today[1].

Turning to family firms, it is important to acknowledge, following Bubolz (2001), that 'the family is a source, builder and user of social capital', and family business can develop unique resources through the interaction between the family and the firm system (Habbershon and Williams 1999). Inside family firms (FFs), cooperation and coordination provide a foundation for the creation and use of family social capital (FSC), which is made up of attributes such as stability, interdependence, frequent interaction, and closure (Arregle *et al.* 2007). In FFs, the importance in continuity in social relations, a longer-term approach to management, and substantial mutual interdependence are some determinants affecting the set network of social relations that provide the basis for trust and cooperation. Closure relates to social boundaries that create strong identities, a clear distinction of members from nonmembers, 'us' from 'them' (Etzioni 1996, 9; Bourdieu 1986). The negative aspects can emerge when "the same strong ties that bring benefits to members of a group commonly enable it to bar others from access" (Portes 1998, 15). Hence, the same ties among family members restrict opportunities for outsiders (employees and shareholders not belonging to the family), permitting only

[1] In a companion paper, Cardullo *et al.* (2022), we show that higher levels of social capital and trust are positively correlated to current quality of industrial and labour relations, as the presence of a two-tier bargaining agreement and cooperative unions.

their restricted access to resources of family enterprise, developing elements of antagonism, that might be conducive to worse performance of FFs.

We expect that these negative aspects are less relevant in FFs that operate in regions that had experienced institutions of self-government, as free city states (communes). This is because in free communes, individuals, bearers of opposing interests, learned to cooperate and confront each other, allowing the growth of a climate of trust even outside the same family group. These experiences are at the opposite of what Banfield (1958) found in a small town of Southern Italy and called 'amoral familyism'. In this town, decisions were adopted to "maximize the material, short-run advantage of the nuclear family, [and] assumed that all others will do likewise" (Banfield 1958, 82). A negative aspect of family social capital was that in this case citizens lacked willingness to subordinate aims of their individual family to those of larger groups.

In this study we expect that in areas where a set of beliefs and values facilitate cooperation among the members of communities (Guiso *et al.* 2006), it is less likely that owner-CEOs consider their firms as 'personal fiefs' and entrust key management positions to their heirs. On the contrary, a side effect of lack of civic participation is dynastic management, a result of inheritance and predetermined set of norms that strengthen ties among family members, but that may turn out to be detrimental in terms of meritocracy and business performance.

We address this issue by estimating the long run determinants of the emergence of FFs (defined as those controlled or owned by a single family) and their different systems of corporate governance. Using a representative sample of Italian public and private firms, we show that higher current levels of trust, related to experiences of self-government as free city states, are negatively related to the probability of being a family firm and observing a dynastic management. On the contrary, higher level of trust are positively related to the probability of appointing an external manager or an internal manager not belonging to the family dynasty, as confirmed by IV estimates. Because free city states developed only in the Centre-North of the country, in this study we do not consider firms in southern regions. The importance of Italy as our case study, analyzed by Banfield to explore the "Moral Basis of a Backward Society", is also evident today. We believe the Italian example is of interest not only because, similar to evidence around the world (La Porta *et al.* 1999; Faccio and Lang 2002), in Italy there is a remarkably high incidence of family businesses. Its peculiar trait is that in most cases the entire management is an expression of the owner family, with a very strong incidence of dynastic management, also in comparison to what found in FFs of France, Germany and Spain[2]. At the same time, familyism and lack of meritocracy in the selection of managers have been diagnosed among the ultimate causes of the Italian disease (Bloom and van Reenen 2007; Pellegrino and Zingales 2017).

Our study intends to contribute to the literature on FFs in different ways. Available empirical studies are often restricted to public company data, and limited research has explored the wide variability in the diffusion of public and private family enterprises within countries. Furthermore, so far, legal, and political determinants of corporate governance systems have permitted to explore how national

[2] The EFIGE database that covers manufacturing firms of more than 10 employees for seven countries show that family businesses in which all management is the expression of the owner family are around two thirds in Italy, only one third in Spain, one fourth in France and Germany, and only 10 per cent in the UK (Bugamelli and Lotti 2018, 31).

differences in financial and labour regulations explain cross-country differentials (La Porta *et al.* 1997, 1999; Crouch 1993; Mueller and Philippon 2011). However, almost all studies suffer from the lack of sub-national measures of rule of law, contracting environments, cultural traits capable to rationalize divergences inside the single economies. Finally, our study intends to be an initial step for a future avenue of research where both the constructs offered by social capital and family social capital theories and their interconnections are considered through the lens of their cultural and historical roots and verified in empirical studies.

The remainder of this work is organized as follows. Section 2 contains a more in-depth review of the different literatures to which this paper is related. Section 3 discusses the data, while section 4 contains the identification assumptions. Finally, section 5 provides the empirical results and section 6 concludes.

2. Background

2.1 Literature on family firms

Extant literature proposes agency and stewardship theories as opposing approaches for viewing the family firm and its management regime (Madison *et al.* 2016; Miller and Le Breton-Miller 2006). Furthermore, the resource-based view and the social capital theory are two other major theoretical frameworks to analyze FFs (Rau 2013; Arregle *et al.* 2007).

According to agency theories, family firms are qualitatively different from non-family firms because they have lower agency costs related to separation between ownership and control (Jensen and Meckling 1976; Fama and Jensen 1983). Concerning management, in principle, family management may perform better because family CEOs have firm specific knowledge, higher levels of trust from key shareholders as well as a more long term focus than non-family management lack (Davis *et al.* 1997).

However, the weight of evidence shows that in FFs the negative effects on firm performances prevail when these enterprises are under the dynastic family control (Villalonga and Amit 2006, 2020). A number of reasons may explain these results.

First, FFs may incur adverse selection problems that are particularly severe when management positions are chosen according to dynastic criteria rather than effective merits. Pérez-González (2006) examines a sample of CEO transitions in U.S. and show that inherited control limits labor market competition; this study shows that FFs that appoint family CEOs significantly underperform relative to firms that promote unrelated CEOs. Furthermore, Caselli and Gennaioli (2013) document the role of inter-generational transmission of managerial responsibilities and find that differences in performances across countries are explained by dynastic management.

Second, family CEOs might underperform because of divergences between family controlling firms and minority shareholder. Controlling families might select family managers (even when firm performance is negatively affected) because family succession permits to enjoy the private benefits of control, as confirmed by the causal effects of family succession in Denmark identified by Bennedsen *et al.* 2007.

Third, FFs manifest an 'asymmetric altruism' problem that makes it difficult for family agents to take actions that might harm another family member's welfare (Schulze *et al.* 2001). As a consequence, excessive generosity in terms of perquisite consumption to family agents, free riding of family members (Bruce and Waldman 1990), and entrenchment of ineffective family managers (Morck and Yeung 2004) are all traits that are unique to family firms (Schulze *et al.* 2003).

Another distinctive trait of family principals may be their desire to preserve socio-emotional wealth, defined as the stock of affect-related value that they derive from their family business (Gómez-Mejía *et al.* 2007), as proposed by the Socio Emotional Wealth view (SEW). The non-economic satisfaction obtained from firm ownership, the dimension of family control and influence (Berrone *et al.* 2012), explain why principals may be reluctant to select non-family managers and prefer a top management team that is more protective of SEW, even when family management actions are decoupled from firm performance.

It has also documented, according to the behavioral agency theory, that familiar altruism negatively influences agency relationships in FFs, as estimated for a sample of family-owned and -managed American corporations (Schulze *et al.* 2003). As observed by the authors, "the CEO's ability to discipline family agents is compromised by both the CEO's altruism, and by the ramifications that such actions might have on familial relationships inside the firm and among the extended family outside the firm" (Schulze *et al.* 2003, 478). Furthermore, FFs are often composed of individuals whose personal aims and family relations may be conflictual, especially among powerful descendants of the founder, which creates a "race to the bottom" in tunneling resources out of the firm, as found by Bertrand *et al.* (2008) for a sample of the largest business families of Thailand.

Fourth, the stewardship view proposed by Davis *et al.* (1997), Donaldson and Davis (1991) offers an alternative conceptual framework and portrays firm subordinates as trustworthy and pro-organizational rather than only self-serving and opportunistic. These attitudes may be particularly relevant when top executives are family members or strongly linked to family owners (Miller and Le Breton-Miller 2006). However, the downside of 'too much' family management may be also conducive to 'poor stewardship', particularly when controlling owner-CEOs consider their firms as 'personal fiefs' (Miller and Le Breton-Miller 2006). Their higher degree of discretion, not subject to board control and intervention, may be contributing to risky decisions or, at the opposite, slowly changes and economic stagnation. Finally, on the basis of the resource-based view (RBV), it has been argued that FFs are themselves sources of valuable, inimitable and non-substitutable resources that let them develop competitive advantages with respect to their non-family counterparts (see Rau 2013 for a review). In particular, "the family is a source, builder and user of social capital" (Bubolz 2001), and ownership and control "stability positively contribute to the development of the family firm's organizational capital" (Arregle *et al.* 2007, 83). However, a number of risks are associated to a strong organizational social capital (OSC), as FFs form a structured group that is trapped in its established networks and with lower propensities to new sources of in- formation. These side effects may be particularly relevant when organizational competencies, intellectual capital and the socialization of tacit knowledge among employees are strategical tools (Nahapiet and Ghoshal 1998).

Employment practices are among the primary mechanisms by which OSC are influenced (Leana and van Buren 1999) because job security can be a potential cost. Dynastic family firms have fewer structured management practices, and the implicit contracts between firm managers and employees for stable positions are behind the adoption of fewer structured management practices (Lemos and

Scur 2019). The importance of firm image and the strong identification of families with the firm are coherent with the social identity theory advocated by Block (2010). This identification renders family business more interested in firm reputation and leads family CEOs to avoid actions such as deep job cuts that damage the image of the firm, leading to a greater reluctance to downsize in relation to non-family firms (Block 2010; Bassanini *et al.* 2013). These strategies may be particular relevant in contexts affected by conflictual labour relations, and where usually FFs are more prevalent (Mueller and Philippon 2011). Along these lines, and in conformity with the Family Social Capital theory, Lemos and Scur (2019) argue that in FFs firing costs are amplified by a 'reputation' effect, the consequence being less structured labour strategies and lower wage incentives. Hence, the key point is not only related to lower competences of family CEOs. More importantly, family CEOs' "are simply responding to differential costs of investing in a type of monitoring technology (here, managerial practices) because of the unique structure of implicit commitments with their employees" (Lemos and Scur 2019, 14). In line with to these arguments, Lemos and Scur (2019) examine a sample of Latin American and European enterprises, and provide causal evidence of negative effects of dynastic family control on internal organization.

2.2 Historical roots of family firms

The present paper situates itself in the literature that finds that the emergence of free communes in North-Center Italy in late Middle Ages has brought a significant cultural change whose effects are still discernible in present times.

Putnam (1993) was the first to advance this path dependence thesis, contrasting the different forms of governments present in Italy well before the Renaissance period: the monarchic feudal that persisted in the South during the Norman period, and the popular-republican that arose in some parts of the North-Center at the end of the 11th century, when some cities emancipated themselves from the strict dominance of the Sacred Roman Empire. In Putnam's words, under the former people were subjects; under the latter, people were citizens. Indeed, the Communes' political system contained a few aspects that are now present in modern liberal democracies: all people, irrespective of their status, were, in principle, citizens in front of the law, administered by the communal tribunals. Moreover, the social ladder was much easier to climb compared to the feudal system, and the so-called minors (the plebs) could become part of the elite (mounted knights and landowners). These are crucial ingredients for the birth of a self-determination spirit among its inhabitants. Putnam's conjecture is that such cultural traits did not disappear after the end of the Communal period (with the advent of the *Signorie* in the 14th century and then in late 14th and early 15th centuries, after the transformation of the *Signorie* into principalities) but persisted over centuries, explaining why today Italians living in areas of Italy where in the distant past a free city thrived, show stronger social capital[3].

[3] There are several definitions for social capital. For Putnam (1993, 19), "social capital refers to connections among individuals - social networks and the norms of reciprocity and trustworthiness that arise from them".

Putnam's thesis has been tested by Guiso *et al.* (2016). They find that, in Northern cities that experienced a period of independence in the Middle Ages, the number of blood donators and the presence of voluntary organizations is higher, whereas the frequency of cheating in a national exam is lower.

This robust positive correlation is obtained after controlling for area dummy variables and other geographical variables, such as closeness to the sea or elevation. For the purpose of our paper, it is important to stress another key element of the free cities system, that is the fragmentation of its social and political fabric. Besides the formal communal institutions, a large plethora of different interest groups and 'intermediate bodies' had their say in most aspects of the civic life: guilds, *confraternite* (associations with religious roots), *compagnie d'armi* (militias) prospered in the communal era, whereas their importance was much limited in the Southern parts of Italy, under the Normans rule (Rutenburg 1973 and Greci 1995). This was not by chance, but precisely because of the relative autonomy they could enjoy in the Communes compared to the centralizing power of the Normans. The divergent economic and political agendas of these groups could lead to overt conflicts, endless negotiations, or fruitful compromises (Greci 1995; Artifoni 1990). In any case, it created an environment where people understood the advantages of being part of a group, of promoting your own interests while interacting with individuals of different extraction or pursuing other objectives. Such a scenario is a far cry from the authoritarian and stifling political landscape that permeated other parts of Italy.

As discussed in the Introduction, related to this line of reasoning is the large literature on 'amoral familism' originated from the influential book of Banfield (1958). Analysing the characteristics of people of Montegrano[4], a village in the South of Italy in the 1950s, Banfield coined the term amoral familism to describe an attitude and a way of living that, for the author, were the main culprit for the region's backwardness. In a society like this, acting together is not contemplated, civic awareness is absent, and the only interests that deserve to be pursued are those of the nuclear family[5]. The only chance for upward mobility is intergenerational, so it is crucial to invest heavily on the offspring. Banfield was convinced that the roots of such a behavior were mainly cultural[6]. However, apart from references to the feudal origins of some social norms in Montegrano, he did not go as far as to relate this to specific historical facts.

The conclusions reached by Putnam and Banfield led to countless comments and discussions, spanning the whole spectrum of the social sciences. It is beyond the scope of this paper to account for all the different receptions they generated. What we want to stress here is that, in contrast to most works stemming from this area of research, our analysis does not look at the Italian North-South cultural divide (its historical roots and its civic and economic consequences). In fact, our empirical

[4] Montegrano is the fictious name used by Banfield to denote the original town of Chiaromonte, in the Southern Italian region of Basilicata.

[5] The hypothesis is that the Montegranesi act as if they were following this rule: Maximise the material, short-run advantage of the nuclear family; assume that all others will do likewise. "One whose behaviour is consistent with this rule will be called an 'amoral familist' […]. In a society of amoral familists, no one will further the interest of the group or community except as it is to his private advantage to do so" (Banfield 1958, 85).

[6] One thing is poverty, another is 'la miseria'. "What makes the difference between a low level of living and la miseria comes from culture. […]. There are primitive societies in which the level of biological wellbeing is even lower, but in which people are not chronically unhappy" (Banfield 1958, 64-65).

analysis shows that resorting to dynastic management is less likely in North-Center Italian firms situated in cities that almost one thousand years before were free communes compared to other firms located in the same North-Center Italian province but in cities that were not free communes. Our interpretation is that the specific cultural aspects of the communal life was trust towards non-family members (as participation to communal life necessarily involved some form of cooperation across kinship lines). This social behaviour has persisted over centuries, surviving when formal institutions perished or changed.

3. Data

The empirical analysis is based on the last three waves of the *Rilevazione su Imprese e Lavoro* (RIL) conducted by Inapp (the Italian National Institute for Public Policy Analysis) in 2010, 2015 and 2018 on a large representative sample of partnerships and limited liability firms operating in non-agricultural private sector. As far as the key explanatory variables are concerned, we consider municipality-level measures of civicness and historical characteristics obtained from Guiso *et al.* (2016), that are discussed in more detail below.

We take advantage from the rich set of information provided by the RIL survey on management and corporate governance, workforce characteristics and firms productive specialization. In particular, we have data on the individual profile of the entrepreneurs, on the ownership structure and managerial selection at the firm level and on corporate governance agreements, which allows us to control for important sources of firm heterogeneity. Further we add information about workforce composition (education, contractual agreements, gender, occupation level, citizenship), firm's productive specialization and competitive behavior (employment, sales per employees, foreign trade agreements, multinational status, innovation etc.) and other variables describing economic activities (sectors) and location (region, province and municipality). Moreover, we exclude firms with less than 10 employees, as non-family firms and very infrequent below that size. In table 1 we provide descriptive statistics for each wave of the RIL dataset on the main variables of interest, i.e., our dependent variables and main controls.

Data at municipality level come from Guiso *et al.* (2016). We refer to their study for detailed explanations regarding the creation of each variable. Here we briefly explain how the main variables of interest are derived. In particular, following the original source, we define as free communes those municipalities that were independent in 1176. In our sample, as reported in table 2, about 30% of observations refer to firms that are currently located in municipalities that were a free commune in the past. Remaining controls refer to urbanization dummies in 1300, geographic location dummies and finally, modern characteristics of the municipalities, such as population levels and Gini inequality index measured as of 2001. In figure 1 we provide a map with details on the main variable of interest, the free commune.

Table 1. Descriptive statistics. Firm level variables

	Mean	Std Dev	Min	Max
	Corporate governance			
External management	0.048	0.213	0	1
Internal management (no family)	0.107	0.309	0	1
Family firms	0.829	0.377	0	1
Dynastic management	0.846	0.361	0	1
	Managers' personal charatcteristics			
Age >49years	0.347	0.476	0	1
34<age<50	0.253	0.435	0	1
Age<35	0.056	0.231	0	1
Female	0.122	0.327	0	1
	Workforce characteristics			
Share of graduated	0.11	0.189	0	1
Share of upper secondary	0.463	0.28	0	1
Share of lower ed	0.427	0.319	0	1
Share of female	0.353	0.262	0	1
Share of immigrants	0.072	0.135	0	1
Share of FT contracts	0.142	0.204	0	1
Share of executives	0.041	0.089	0	1
Share of white collar	0.359	0.299	0	1
Share of blue collars	0.6	0.323	0	1
	Firms' characteristics			
Mergers & acquisitions	0.062	0.241	0	1
Multinational	0.033	0.178	0	1
Innov product	0.429	0.495	0	1
Innov process	0.385	0.487	0	1
International trade	0.346	0.476	0	1
foreign trade agreement	0.156	0.363	0	1
ln(sales per employees)	11.741	1.265	0.1	16.7
	Firms' size			
N of employees<50	0.867	0.34	0	1
49<n of employees<250	0.114	0.317	0	1
N of employees>249	0.019	0.138	0	1
N of of obs		25,840		

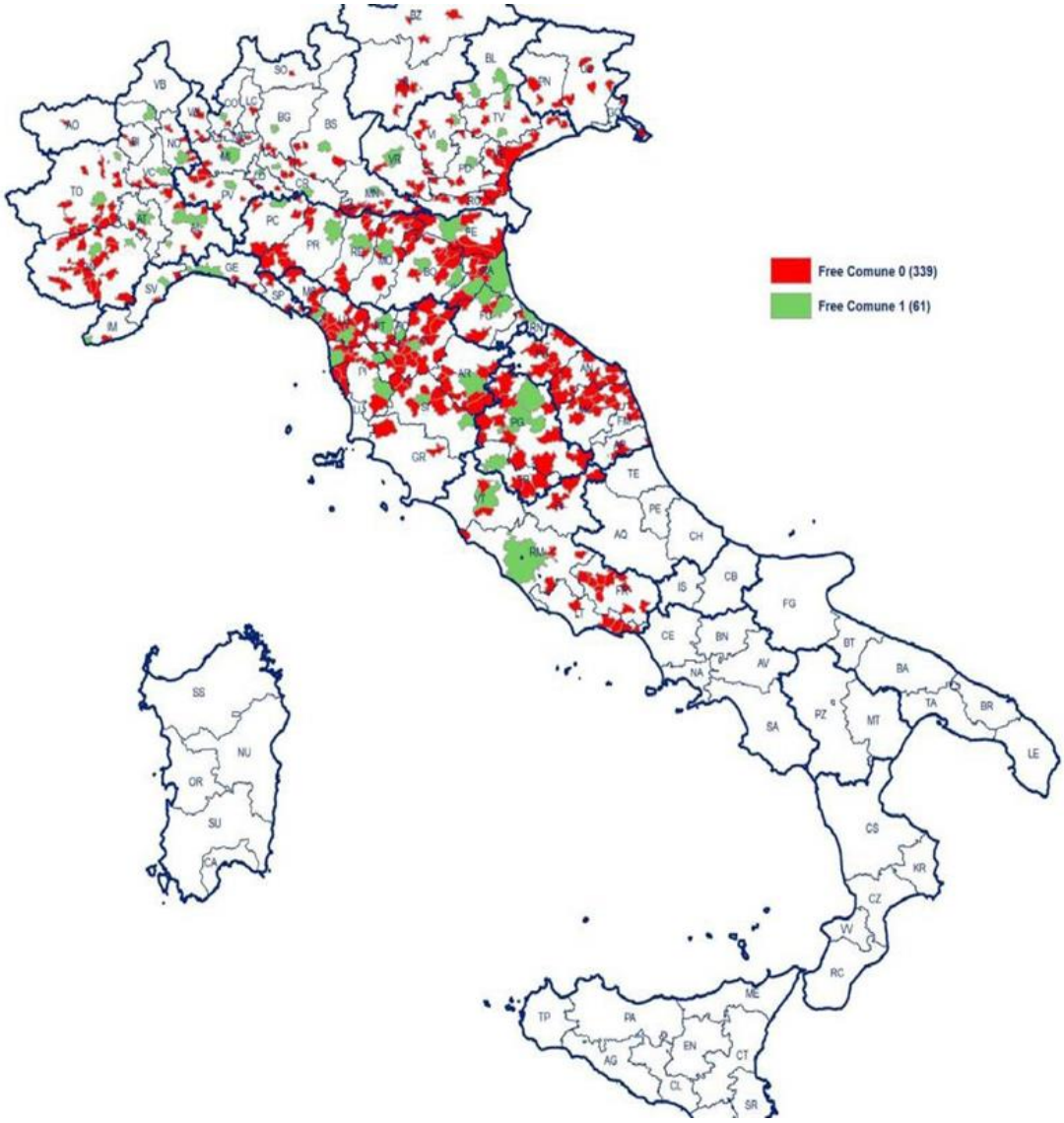
Note: family firm is a dummy equal to one for firms controlled by a family; dynastic management is a dummy equalt to one for firms with a manager belonging to a family dynasty; external management is a dummy equal to one for firms with an external manager. Management characteristics are dummy variables. Shares are characteristics are calculated at the firm level. Multinationals, product innovation, process innovation, foreign markets, trade agreements are dummies. Sampling weights applied.
Source: our calculations on RIL 2010-2014-2018 sample data

Table 2. Descriptive statistics at municipality level

	Mean	Std. Dev.	Min	Max
Free commune	0,30	0,46	0	1
Medium pop.	0,03	0,18	0	1
Large pop.	0,25	0,43	0	1
Costal	0,16	0,36	0	1
Near the sea	0,02	0,13	0	1
Altitude	0,17	0,20	0	2,04
Population 2001	0,27	0,61	0	2,55
Gini inequality	0,41	0,04	0,30	0,61

Note: free commune is a dummy equal to one for municipalities that experienced a free commune in the Middle Ages. Medium and large population are dummies for population size in the Middle Ages. Coastal, near the sea and altitude are geographic dummy variables. Population 2001 is expressed in millions inhabitants and rounded. Gini income inequality index varies at municipality level.
Source: Guiso *et al.* (2016)

Figure 1. Free communes in the Middle Ages



Note: we refer to their study for detailed explanations regarding the creation of each variable. In particular, following the original source, we define as free commune those that were independent in 1176.
Source: data at municipality level are from Guiso *et al.* (2016)

4. Identification

We identify the long-term causal effects of the medieval free commune on the current setting of corporate structure using a representative sample of Italian firms in the Centre-North of the country by contrasting certain features of the structure of corporate governance (e.g. probability that a firm is family-owned, or presence of managers with dynastic ties with the ownership) in firms that are located in municipalities that experienced a spell of free commune with those that prevail in similar firms that are in turn located in municipalities that never had free commune institutions in the Middle Ages, which act as 'control municipalities'.

Our identification strategy is based on the estimation of the following equation by OLS:

$$CGimpt = \alpha FCmp + \beta Ximpt + \vartheta Mm + up + vimpt \quad [1]$$

where *i* indexes firms, *m* municipalities, *p* provinces and *t* the RIL waves 2010, 2014 and 2018, respectively. The sample is composed of a repeated cross section with a panel component, i.e. we can observe a fraction of firms over the three waves.

In the above equation *CG* may represent, alternatively i) a dummy taking the value of 1 if firm *i*, located in municipality *m* and province *p* in wave *t* has an external manager; ii) a dummy equal to 1 for those firms with a internal management not belonging to the main family; iii) a dummy equal to 1 for those firms that are defined as family-firms; iv) a dummy equal to 1 for those firms that are characterized as dynastic ones. In turn, *FC* is equal to 1 if firm *i*, in province *p* in wave *t* is located in a municipality *m* that experienced a spell of free communal institutions in the late Middle Ages. Moving to the controls, *X* is a set of controls at the firm level, which capture firm level differences in managerial characteristics (such as age and sex), workforce composition (e.g. age, sex, education, citizenship) and firm productive specialization (e.g. innovation, export orientation etc.), besides a full set of industry and year dummies. In turn, *M* captures a set of historic[7], geographic[8] as well as modern[9] characteristics of the municipality *m* where firm *i* is located. The historic controls are proxy for the degree of urbanization in the Middle Ages, which is perhaps the best proxy for the relative degree of economic development that is available for such a large cross section of municipalities. We have this information for about 1300 C.E. While it would be better to have information on population at about 1000 C.E. (when most free communes developed), we think that controlling for population as of 1300 should be enough, given that Bosker *et al.* (2013) showed that, in Europe, the creation of a free commune was correlated with initial city size, but that the presence of free communal institutions were strongly correlated with future population growth. In turn, the geographic characteristic we control for should proxy for the trade potential of a municipality, which is well known to foster trust and cooperative behavior.

Finally, *up* represents a full set of province fixed effects that capture the NUTS-3 region where each firm is located during wave *t*, while *vimpt* is an error term. The inclusion of the province fixed effects amounts to identify the impact of the free communal institutions only by comparing firms in treated and control municipalities within the same NUTS-3 region. This is crucial for different reasons. First, because in this way we eliminate possible effects of other subsequent local institutions and foreign dominations that characterized Italy since the Renaissance, as noted by Di Liberto and Sideri (2015) who showed, using province-level data, that the current quality of local institutions are strongly and significantly affected by the quality of past local institutions; second, by comparing firms in closer municipalities we eliminate the effects of location-specific shocks that might have affected trust and institutional development, a shown for the regions of Europe by Buggle and Durante (2021). Finally,

[7] We consider two dummy variables which indicate the size of the municipality *m* as of 1300 (namely, medium, or large) as in Guiso *et al.* (2016).

[8] We include a dummy for whether the municipality is near to the sea, its altitude as well as a dummy for costal municipalities.

[9] We control for some predetermined modern characteristics of each municipality, such as the number of inhabitants and the Gini index of inequality, both measured as of 2001.

the historic, geographic, and current municipality controls should ensure that identification is achieved by comparing firms, within the same province, that are located in similar municipalities, the only difference being the presence of a past spell of free medieval communal institutions, while firm level controls should take into account observed differences among firms.

5. Results

We begin our analysis in column [1] of table 3 with a parsimonious specification that includes, for the entire set of our dependent variables reported in panels A, B, C and D, as main regressor a dummy equal to 1 for those firms located in a municipality where a free commune was present in the Middle Ages. In this specification we also include (arguably exogenous) baseline controls for firms' size, sectors of activity, year and province fixed effects. We find that the experience of a spell of free commune in the late Middle Ages for firms located in the Centre-North of Italy is positively associated both to the probability that the firm is run by an external manager (panel A) and to the probability that an internal manager not belonging to the family is appointed (panel B). On the other hand, in Panels C and D we uncover a negative relationship between the location of a firm in commune that was a free commune in the Middle Ages and the probability of being a family firm (panel C) and to the probability of observing dynastic management at the firm level (panel D).
The coefficients of interest in column 1, panels C and D of table 3 are broadly similar and statistically significant at conventional levels, suggesting that the diffusion of family firms and dynastic management are interrelated and that the two regressions are broadly capturing similar patterns of arrangements for firm governance.
We augment the set of controls in order to check the robustness of our main results in column 2 of table 3. In particular, we consider the possibility that some municipality level characteristics may have impacted both on the probability of the emergence of a free commune in the Middle Ages and on corporate governance arrangements today. On the one hand, we consider the role of geographic and modern municipality characteristics as the current population levels and Gini inequality index that, again, may be correlated to the emergence of some particular type of corporate governance. On the other hand, we include other municipality levels controls (geographical location, historical population, among the others) that may impact both the establishment of a free commune in the Middle Ages as well as the long run patterns of growth that might be correlated with the current type of firm level governance arrangements. The inclusion of the two sets of controls reported in column [2] does not change the overall picture: firms located in municipalities that in the Middle Ages experienced a free commune episode still have higher probability of appointing a manager not belonging to the family (either external or internal) and lower probabilities of being held by a family and being run by family managers that are passed on from one generation to the other. Although slightly reduced, the coefficients of interest are of similar magnitude with respect to our previous parsimonious specification, at least for regressions reported in panel B. On the other hand, the inclusion of such controls reduces the coefficient of interest by half in panel A where the dependent variable is a dummy for the probability of appointing an external manager. In this case, the statistical significance of the coefficient of interest is also reduced, even if it is still significant al 10%.

Table 3. Main results. Pooled OLS estimates

	[1]	[2]	[3]
	Panel A: External manager		
Free commune	0.025***	0.014*	0.013*
	[0.004]	[0.008]	[0.008]
N of obs	29454	29454	25327
	Panel B: Internal manager (no family)		
Free commune	0.041***	0.041***	0.040***
	[0.006]	[0.011]	[0.011]
N of obs	29454	29454	25327
	Panel C: Family firm		
Free commune	-0.068***	-0.043***	-0.029**
	[0.008]	[0.013]	[0.013]
N of obs	29498	29498	25347
	Panel D: Dynastic management		
Free commune	-0.066***	-0.055***	-0.053***
	[0.008]	[0.013]	[0.013]
N of obs	29454	29454	25327
Other controls			
Size, year, sector, province	YES	YES	YES
Municipality controls	NO	YES	YES
Firms characteristics	NO	NO	YES
Workforce characteristics	NO	NO	YES

Note: dependent variables: in panel A it is a dummy equal to one for firms with an external manager in place; in panel B is a dummy equal to one for firms with with an internal manager not belonging to the family dynasty; in panel C is a dummy equal to one for firms controlled by a family; in panel D is a dummy equal to one for firms with an external manager in place. Controls at the bottom of the table refer to regressions in panels A, B, C and D. All regressions controls for firm size, sectors of activity, province fixed effects and year fixed effects. Municipality controls include altitude, coastal location, near sea, dummies for population in the Middle Ages, current population, gini inequality index; firm characteristics include dummies for age and gender of the manager, foreign trade, log of sales per employee, multinationals, product innovation, process innovation, foreign trade agreements, presence of performance related pay agreement, value added per worker; workforce characteristics controls for the composition of the employee by education, gender, contractual arrangements, occupation and citizenship. Standard errors clustered at municipality levels in parentheses.
Source: our calculations on RIL 2010-2014-2018 sample data

In order to control for additional firm level characteristics that may impact on the emergence of different arrangements in terms of corporate governance today, in column 3 of the same table, we augment our models with a set of firm and workforce level characteristics. We include managerial demographic characteristics (age and gender of the manager), workforce composition (shares by education, age, gender, type of contracts, share of immigrants, main occupations etc.), firms' productive characteristics (export in foreign markets, trade ageements, (log of) sales per employee, innovation and multinationals dummies). Of course, this set of controls might be endogenous, and a bad control problem might arise with our estimates. Reassuringly, our coefficients of interest are barely changed, at least in panels A, B and D, suggesting that the size of the effect is not driven by the inclusion of such controls. Results reported in panel C instead suggest that although the statistical significance of our estimates is slightly reduced with the respect to the previous set of regressions[10].

[10] In tables not reported, but available from the authors upon request, we run the same regressions on the sample of firms located in the municipalities in the North of the country, thus excluding those located in the Center. Results are confirmed.

The fact that the step-by-step introduction of a such rich set of controls has a differential impact on the size and statistical significance of our main regressor of interest (the free commune) on our types of corporate governance suggests that unobservables may have different degrees of importance in our identification setting.

As far as the magnitude of the coefficients is concerned, we note that the impact of the free medieval commune is quite important, especially in the case of family firms and dynastic management. Indeed, our results suggest that being located in a municipality that used to be a free medieval commune is associated to a decrease of about 2.9 (5.3) per cent on the probability that a firm is considered as a family firm (run by the same family managers across generations). This is a quite large effect if we consider that, in our sample, family firms (dynastic firms) constitute more than 80% of our observation.

As discussed in the Identification section, although our OLS estimates control for a large set of current and past observable characteristics both at the firm and municipality level, there still could be some unobservable characteristic that may be positively correlated to our main regressor of interest, i.e. the dummy for being a free city states in the Middle Ages. In that is case, our OLS estimates cannot be given a causal interpretation of the effect of free commune on the corporate governance arrangements today. Hence in table 4, we report the results for our IV estimates in which we instrument the dummy for the free commune with a dummy equal to one for the presence of a bishop in the past. While we have already discussed the rationale for using such instrument in previous sections, here we just mention that the emergence of a commune was more likely in cities that had a bishop in place. Our first stage estimates, that are reported at the bottom of the table, confirm our expectations. Indeed, the bishop dummy is positive and highly statistically significant; second, standard test for identification suggest that we do not have a weak identification problem[11].

Results from our IV regressions, reported in table 4, confirm our main OLS results, at least for the fully saturated model with the entire set of controls and fixed effects. This is true for the four dependent variables corresponding to different corporate governance arrangements. The estimated effects for our IV are larger than the OLS ones. For example, the estimated coefficient for a firm being controlled by a family in the fully saturated model is equal to -0.111 (against -0.029 obtained in the OLS regressions). This somewhat larger effect in the IV estimates might suggest that OLS are downwards biased, possibly because of, e.g., some local unobservables at municipality level that favored the birth of a medieval free commune but that currently discourage firms from hiring external managers moving from a familiar to a more market oriented management system. Nevertheless, it is important to recognize that OLS and IV might be estimating different average treatment effects: indeed, IV estimates should identify a local average treatment effect, namely the effect of the free medieval commune on compliers, i.e. firms located in those municipalities that become a free medieval commune precisely because of the presence of a bishop. If the effect of the free medieval commune experience is heterogenous across locations, then it is possible that the local average treatment effect is different from the average treatment effect estimated by OLS.

[11] Complete first stage results are available from the authors upon request.

Table 4. 2SLS-IV estimates

	external management	internal management	family ownership	dynastic management
	[1]	[2]	[3]	[4]
Free commune	0.055***	0.056***	-0.111***	-0.068**
	[0.019]	[0.021]	[0.026]	[0.027]
Controls				
size, year, sector, province	YES	YES	YES	YES
Municipality controls	YES	YES	YES	YES
Firms characteristics	YES	YES	YES	YES
Workforce characteristics	YES	YES	YES	YES
N of Obs	25355	25355	25317	25355
	First stage statistics			
Excluded instrument				
Bishop	0.330***	0.330***	0.330***	0.330***
	[0.050]	[0.050]	[0.050]	[0.050]

Note: dependent variables: in column 1 it is a dummy equal to one for firms with an external manager in place; in column 2 is a dummy equal to one for firms with an internal manager not belonging to the family dynasty; in column 3 is a dummy equal to one for firms controlled by a family; in column 4 is a dummy equal to one for firms with an external manager in place. All regressions controls for firm size, sectors of activity, province fixed effects and year fixed effects. Municipality controls include altitude, coastal location, near sea, dummies for population in the Middle Ages, current population, gini inequality index; firm characteristics include dummies for age and gender of the manager, foreign trade, log of sales per employee, multinationals, product innovation, process innovation, foreign trade agreements, presence of performance related pay agreement, value added per worker; workforce characteristics controls for the composition of the employee by education, gender, contractual arrangements, occupation and citizenship. Standard errors clustered at municipality levels in parentheses.
Source: our calculations on RIL 2010-2014-2018 sample data

6. Concluding Remarks

To rationalize the presence of family firms (FFs), the 'law and finance' area of research, pioneered by La Porta *et al.* (1997; 1999), has shown that family-owned and controlled firms are a reaction to weak formal institutions[12]. Adopting a different approach, Roe (2003) focuses on political determinants in corporate governance and suggests that when governments pay more attention to workers' requests and press managers to stabilize employment, a counter pressure inside the firm may be concentred ownership. The historical causes for the differences in the quality of labour relations across countries, analyzed by the historian Colin Crouch (1993), contribute to explain why family ownership is more prevalent in countries in which labour relations are conflictual (Mueller and Philippon 2011). However, large gaps may emerge within countries (Iacovone *et al.* 2019).

In this paper, we have explored the causal role of long run cultural determinants of presence and distribution of family firms and their different systems of corporate governance. Indeed, an emerging literature has clarified that high levels of social capital and cooperative attitudes are positively related to development along various dimensions at local level. Moreover, it was shown that current levels of

[12]La Porta *et al.* (1999) examine the ownership structures of large corporations in 27 developed countries and report that widely held corporations predominate among large firms only in the US and UK. Elsewhere, particularly in countries with poor legal protection for shareholders, even the largest corporations have families as controlling owners.

social capital are highly persistent over time: this evidence may give a key role for historical institutions to explain current types of corporate governance. In this paper, we investigate the emergence of family firms and their different systems of corporate governance by using historical information on Italian municipalities in the Middle Ages (Guiso *et al.* 2016) and looking at their impact on dynastic or internal management in current times.

The empirical analysis is based on Italian data for a sample of firms observed over the period 2010-2018. We show that, conditional on a large set of observable characteristics at the province, municipality and firm level, higher current levels of trust, related to the experience of a free commune in the Middle Ages, are negatively related to the probability of being a family firm and to detecting a dynastic management. On the contrary, higher level of trust are positively related to the probability of appointing an external manager or an internal manager not belonging to the family dynasty.

We choose Italy as a case study not only because, similar to evidence around the world, it has a remarkably high incidence of family businesses. Its peculiar characteristics is that the vast majority of firms the entire management is an expression of the owner family, with a significant prevalence of dynastic management, also in comparison to what found in family firms of US or other European countries like France, Germany and Spain. Moreover, it was found that the recent Italian disease and the abruptly stop of Italy's aggregate productivity growing in the mid-1990s, may be also due to familyism and to lack of meritocracy in the selection of managers (Pellegrino and Zingales 2017).

We also confirm our main empirical results using an instrumental variable strategy. In line with Guiso *et al.* (2016), we assess that the emergence of a free commune was more likely in cities that were already seats of a bishop. Our IV estimates confirm our main findings of a positive relation between the free commune experience and the probability of appointing an external manager or an internal manager not belonging to the family dynasty.

Policy implications are relevant also because enterprises run by families quite often experience serious costs that arise from conflicts of interest between controlling family shareholders and minority shareholders (Shleifer and Vishny 1997) and play an important role in determining a high level of political corruption within an economy, more than nonfamily firms. FFs indeed have longer time horizons than their nonfamily counterparts and because of this long-term orientation, politicians might prefer to exchange 'favors' with wealthy family enterprises that exert long term continuous control over very large groups of firms of their national economies (Morck *et al.* 2005).

Our results are far from conclusive but open an interesting area of research: the distribution of family firms through the lens of the long run determinants of social capital. Future research will be able to test the extent and the importance of this new channel in explaining the nature of corporate governance around the world. At the moment, we can only confirm that it seems to be relevant in the Italian experience.

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INAPP
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