LUISS Guido Carli

LIBERA UNIVERSITÀ INTERNAZIONALE DEGLI STUDI SOCIALI

Department of Impresa & Management

Chair of Entrepreneurship and Venture Capital

The role of Private Equity in the context of Italian family businesses

Supervisor	Candidate
Prof. José D'Alessandro	Giulia Toti
Co-Supervisor	No. 696601
Prof. Luigi de Vecchi	

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Preface

Private equity is an institutional investment activity carried out through the acquisition of significant or minority equity investments in the risk capital of a company with a medium to long-term perspective. This investment activity, in recent years, is carving out increasing important slices of the market, not limited to marginal positions but also to leading ones. This has led theorists and not only, to consider it as one of the factors of major change, preparatory to the economic and entrepreneurial development not only of our country, but on a global scale. In addition, it is seen as an asset class of primary importance through which large institutional investors can implement diversification strategies, given a risk/return profile that is not always easy to identify.

The subjects active in this sector are "risk entrepreneurs who, in addition to their entrepreneurial spirit, combine technical, managerial, financial and organisational skills". In addition, thanks to their national and international contacts, they are able to accumulate more capital, both of their own risk and of others. The aims, in addition to the mere gain, are multiple:

- promote new companies;
- revitalize and launch in a new cycle of development old companies;
- stimulate smaller companies to reach more appropriate size;
- develop and disseminate, as a company, new technologies.

In recent years, many *family businesses* have resorted to *private equity*, recognizing it as an instrumental function in helping them in their future objectives.

Family businesses have become the real backbone of the Italian entrepreneurial system and for this reason it is interesting to understand the challenges they face to ensure their continuity over time and their economic growth.

The aim of the thesis is, on the one hand, is to provide a synoptic picture of the entrepreneurial role of *family businesses*, paying particular attention to the phenomenon of investment by private equity funds and, on the other hand, to examine the results achieved through the use of *private equity* with an eye of interest towards the internationalization and diversification of *family businesses.*

In the first chapter, the definition of *private equity* is examined in depth, paying particular attention to its characteristics and comparing the Italian market with the U.S. market.

In the second chapter, *family business*es are analyzed from the inside, looking at the aspects that can guarantee continuity and growth. The *family business* is generally strongly linked to its entrepreneur. Therefore, the analysis carried out is centred on the figure of the entrepreneur and on the means he has to face the generational change, a critical phase for every *family business*. If business continuity must be guaranteed by the skill of the entrepreneur and the will of his family, growth must be supported by an appropriate organization, good rules of corporate governance and financial liquidity that, in recent years, is often lacking among Italian *family businesses.*
The third chapter examined how in the Italian context private equity funds represent a solution to bring more capital to businesses, specifically to counteract the imbalance towards the banking system and to ensure continuity and growth for *family businesses.*
In the fourth and fifth chapters, a comparison is made on the use of *private equity* in order to help two Italian companies in achieving their objectives: in the case of the Pasubio Tannery, the path pursued is that of internationalization, while in the case of the Rino Mastrotto Tannery, the objective is the diversification of its products.
Finally, conclusions, limitations, implications and avenues for future research will be drawn up.

Chapter 1
Definition and framework

Overview: 1.1 P*rivate equity*: origin definition and characteristics. 1.2 P*rivate equity*: strategies, aims and objectives. 1.3 A comparison of *private equity* in Italy and the Unites States. 1.4 The *private equity market: facts and trends.*

This chapter defines and analyses *private equity* and its characteristics. It examines *private equity* as an important tool to restore businesses in crisis, giving managerial and economic support to the restructuring processes necessary due to the lack of generational turnover, wrong strategic choices, aggressive competition, and then to continue by showing a comparison between the Italian and U.S. financial markets. Finally, the evolutionary trends of recent years in the field of private equity with reference to the Italian market were examined.

1.1 P*rivate equity*: origin, definition and characteristics

The term *Private Equity* refers to the investment activity in the risk capital of unlisted companies. *Private equity* funds are closed-end securities funds that raise capital from individuals and institutional investors, such as banks, foundations, insurance companies and pension funds to invest in unlisted companies with high growth potential. The *mission* of *private equity* is to support the development of companies in critical periods of their life cycle and then take advantage of it through the listing on the stock exchange. The investments of the funds can also be presented as negotiated transactions, subject to evaluation, structuring and *pricing* processes outside the stock market and to the reference to quoted prices. With this last term, we refer to the classic meeting between supply and demand that takes place in the listing markets and that allows all operators involved to be able, in a very short time, to evaluate a company.

In general, the success of the intervention is determined by the investor's ability to contribute to the creation of value within the company, generating, in most cases, wealth also for the entire economic and entrepreneurial fabric of the country.

Private equity can be used to solve problems associated with the ownership structure of a company and for its reorganization, which usually takes place through *buyout*[1] operations carried out by experienced managers.

Investments in the *private equity* sector are characterised by the following characteristics:

- the sharing of entrepreneurial risk by the investor;
- the time horizon of the investment between three and seven years;
- the active involvement of the investor in the management and development of the investee company;
- the high attention paid to the strategic and industrial characteristics of the investee company rather than to the exclusively financial type.

The birth of PE operators has allowed companies to benefit from new capital to be allocated to development and to avoid the problems of credit rationing. These problems were due to uncertainty and lack of information that characterize the organizations in which the funds themselves invest.

The information asymmetries between entrepreneurs and lenders have historically represented barriers to obtaining financing as they make it difficult to determine the value of investments and give rise to opportunistic behaviour on the part of entrepreneurs[2].

Over time, *private equity* organisations have developed the right skills to successfully deal with these types of problems through a mix of non-monetary instruments, which in this context are of fundamental importance: the careful selection of investment opportunities, the continuous monitoring of investments undertaken and the constant managerial support, are the basis of success in *private equity*.

In 1986 the creation of an association called AIFI was born, initially composed of nine private financial and banking companies that joined forces to create this new institution.

Initially, it was called *Associazione Italiana delle Finanziarie di Investimento* (Italian Association of Investment Finance) and its aim was to formally regulate all

[1] A. Gervasoni, *L'impatto economico delle operazioni di private equity* e *venture capital*, Guerini, Milano, 2008.

[2] F. Sottrici, "*Venticinque anni di private Equity in Italia: evoluzione e caratteristiche dall'origine ai giorni nostri*" LUIC Paper, febbraio 2013.

the risk capital investment activities that were already carried out by various operators.
The main activities of the Association were the implementation of investments in companies in the form of risk capital through the assumption, management and disposal of investments, mainly minority and in companies not listed on the Stock Exchange, with a strong involvement in the development of the investee companies, without assuming the entrepreneurial responsibility of the same.
From the beginning the members who joined the association were of two categories, the associate members on the one hand and the associate members on the other, being part of one or the other category was related to the type of activity carried out and consequently to the degree of involvement. In the case of associate members, the companies had to be of Italian nationality and have the form of a joint-stock company, whereas in the case of associate members, professional firms, auditing firms, universities, research firms, credit institutes and many others, both Italian and foreign, could also be associated, representing a group of interests such as to influence the development of risk capital in our country.
With the increase in activities and the strong expansion in the private sector in 1994, the name was changed to "Italian Association of Institutional Investors in Risk Capital" to include also closed-end funds that were born in 1993.
Subsequently, technical commissions were created within AIFI with the aim of creating working groups with a focus on specific topics and activities in order to be able to deal more efficiently with any specific problems, critical issues and relevant issues.
Currently, the working committees are related to the different segments of private debt, private equity, venture capital, tax and legal and M&A.
Currently the mission is:

- to develop and harmonise all the activities of venture capital companies;
- to represent the interests of members both in our country and abroad and encourage cooperation between companies involved in the sector, promotes the collection and dissemination of information and contacts between members and between them and the market and disseminates the culture of venture capital;
- to expand and consolidate relations with the various regulatory bodies, to supervise in order to promote the enactment of legislative measures aimed

at regulating the institutional investment activity. This is why one of the main activities carried out by AIFI is the active participation in the legislative and institutional process, through intense lobbying with the competent authorities;

- very important finally deals with spreading the culture of investment in venture capital among entrepreneurs, a very difficult activity because there is a basis of non-knowledge, ignorance and perhaps "fear" towards this world.

The AIFI carries out various activities, starting from the institutional one, thanks to an intense lobbying activity in order to carry out initiatives aimed at creating an advantageous context for private equity and venture capital. The members are active collaborators and have representation in Parliament and in other organizations, Italian institutions.

Another activity concerns the organization of seminars and conferences open also to the public with a *focus* on specific topics and on the analysis of the latest data relating to the previous year with the presentation of the results of the most recent and important research. The seminars are instead prepared in relation to themes proposed by the members themselves and are held by professionals.

“The purely institutional activity deals with:

- discuss with the institutions the relevant regulations for the sector and the incentive instruments to achieve a clear and certain regulatory framework for intermediaries;
- dialogue with national associations of the sector in other countries to share common policy objectives;
- coordinate the Tax & Legal Commission on juridical, legal and fiscal activities;
- relate with the Associates on specific themes and on doubts relative to the operational areas”[3].

According to the different phases of the life cycle of the target companies, which are characterized by different capital requirements and managerial support, it is possible to distinguish between:

- early stage financing operations;

[3] AIFI, Deloitte, *Il mercato italiano del private equity, venture capital e private debt*, 2018, p. 10

- expansion financing operations;
- buyout operations.

While the first two are placed within the venture capital activity, i.e. the investment and financing activity of the company aimed at supporting the creation and development of companies with high growth potential.

Early stage financing operations are aimed at young companies, which, being characterised by low profitability and a lack of fixed assets to be used to guarantee any financing received, would hardly be able to raise capital with traditional means.

Expansion financing operations, on the other hand, have the aim of consolidating the development of mature companies through the creation of a strong partnership between the entrepreneur and the institutional investor, which, in addition to providing the capital necessary to finance the development plans of the companies, brings within it a set of skills that are indispensable to achieve growth objectives.

Finally, *private equity* in the strict sense of the term is represented by buyout operations, aimed at the total or partial change in the shareholding structure of the target company.

In most cases, this type of operation is carried out with the LBO technique, i.e. with the use of a particularly high level of financial leverage.

Early stage financing operations represent the operations in which venture capitalists invest the most of their resources (56-60%). In early stage financing operations, the entrepreneur mostly brings the idea and knowledge of the business, while the investor, in addition to constant managerial and strategic support, brings the financial resources necessary to support the development of production and the various business functions.

In the start-up phase, the product has already been developed, verified and market research has already been conducted by the company's management.

Early stage financing operations in the world represent those with the highest failure rate and the main challenge for venture capitalists is to identify a management that is able to manage high growth in a context of high uncertainty[4].

Expansion financing operations are part of the venture capital operations carried out by institutional investors. It is a temporary investment in shares of the company's capital, which usually takes place through the subscription of a capital

[4] N. Miglietta – R. Schiesari, *Il private equity nel sistema impresa. Luci ed ombre dell'investimento in capitale di rischio*, G. Giappichelli, Torino, 2013, p. 48

increase or a convertible bond loan and is aimed at financing the development phases of the company. Usually, growth is pursued either internally (through, for example, an increase in production capacity) or through a process of geographical diversification or an M&A strategy, or through a process of integration with other activities.

The different European entrepreneurial structure, more focused on family businesses respect to the Anglo-Saxon one, has meant that private equity operators have developed a different way of operating. The investment usually takes the form of the acquisition of minority shareholdings.

The entrepreneur, in fact, most of the time does not want to lose control of their company but, despite this, at certain times in the life it may feel the need to reorganize it to start a phase of development or to better manage a generational change. Generational changes are critical moments, during which the stability of the company, and its very survival, can be put in serious danger if the subjects in charge of the succession are not able to govern the company of which they become owners.

The third category of risk capital intervention, to which most of the sector's resources are dedicated, is represented by buyout operations aimed at partial or total change of ownership of the company by *private equity* funds and experienced managers.

Unlike what happens in start-up and development operations, in buyout operations the private equity operator takes control of the company in which it invests, and this is why in such situations we do not talk about partnerships with the entrepreneur. In most cases, buyouts are carried out using the leveraged buyout *(LBO[5])* technique. This technique consists in acquiring a company using a large part of the borrowed capital, limiting the buyer's financial investment, in terms of risk capital, only to a limited part of the purchase price. Subsequently, the debt is repaid with the cash flows generated by the acquired company and with the sale of business units or individual assets considered non-strategic.

[5] Ibidem

1.2 P*rivate equity*: strategies, aims and objectives

The process of identifying investment strategies is one of the most important steps for a *private equity* firm and the factors leading to this process are the following:

- the characteristics of the operator;
- the geographical area of intervention;
- the type of investments made.

The characteristics and, in particular, the image and reputation of the operator in the reference market, significantly influence its ability to generate a continuous flow of investment opportunities[6].

The *private equity* industry is now much more competitive than it was a few years ago and that is why companies operating in this sector are increasingly aware that building a strong *brand* is an indispensable element of differentiation that has a positive impact on their balance sheets.

A strong *brand* helps generate new investment opportunities, raise funds and attract talents. While the importance of a strong brand identity is recognized, it is also important for operators to make their past experiences and achievements known to the market. For this purpose, most international operators make use of traditional marketing channels, but not only. In recent years, most companies have strengthened their presence on social media such as Twitter, Facebook, LinkedIn, to build direct contact with investors.

Another essential peculiarity to maximize the *deal flow*[7] is represented by the characteristics of the geographic market in which the operator intends to operate.

Finally, in the phase of identification of investment opportunities it is not possible not to take into account the typology of operations that the operator intends to carry out.

Most of the funds are aware that different skills are needed to invest in the different phases of the company's life cycle and it is for this reason that, from the beginning, the fund chooses its own operating environment, focusing, for example, on early stage financing, expansion financing or buyout operations.

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[6] F. Sottrici, "*Venticinque anni di private Equity in Italia: evoluzione e caratteristiche dall'origine ai giorni nostri*", op. cit., p. 66

[7] Ibidem

Specialisation, in fact, allows a deeper knowledge and allows the creation of greater value. *Private Equity* requires that the management of the company be managerial, and this entails a well-defined organisational structure, the exact definition of the responsibilities of the people who make the decisions, the objectives to be achieved and the process of controlling the achievement of these objectives.
The definition of the objectives and the evaluation of the performance by the funds are intrinsically value-oriented: there is a basic clarity about which drivers lead to the creation of value, because the awareness of this makes the company more ready for a possible listing or otherwise meets the objectives of the fund. The fund provides knowledge and suggestions; indirectly, its presence entails a greater credibility of the company and makes it possible to improve relations with the market and the credit system.

In this way, the company becomes part of a network in which to develop synergies and growth opportunities. This aspect takes on greater importance if the investor's intervention takes place in an SME which, usually, shows shortcomings in terms of value-oriented management.

Small and medium sized entrepreneurs should not be considered incapable of performing their task, on the contrary, they are usually good at intuition, but often, they are driven by the desire to grow in terms of turnover and lack a strong and appropriate financial culture. In family businesses it happens, therefore, that in the heirs do not have the entrepreneurial resources necessary to keep the business alive and it is, therefore, necessary to go and find them on the external management market.

The presence of a PE fund in the capital of an SME makes this process easier, the companies are attractive to the eyes of the best managers, and this also contributes to the development of companies, as they improve the economic-financial performance and competitiveness[8].

The presence of SMEs may represent a strength in terms of flexibility and adaptability, in fact it does not facilitate comparison at the international level.

[8] A. Gervasoni, *L'impatto economico delle operazioni di private equity* e *venture capital, op.cit.*

The presence of a PE fund in the capital of a company helps in this sense because it pushes companies to have commercial and financial contacts even outside their industrial district and, often, of Italy, is a strong motivation to achieve maximum development, encouraging greater propensity to support the risk of undertaking a process of international growth in the face of potential and high future returns. The presence of an institutional investor pushes the company to adopt clear and transparent rules of governance, expressly in the statute.

The system of governance rules aims to regulate the stability of the corporate structure and the incentive of the entrepreneurial partner and the management, the governance of the company and the corporate information, the divestment by the investor partner.

Private equity has the function of pushing the entrepreneur to open himself up to the outside world, to favour the constitution of the board of directors with members who do not strictly belong to the family, in order to obtain greater autonomy in the management of the company.

Private equity operators create value because they are able to favour a more efficient supervision and monitoring activity, bringing in a series of government rules whose main objective is to combine the interests of the different actors involved in the company so that all contribute to its creation of value[9].

Private equity also contributes to the relaunch of the system in terms of both innovation and technology transfer: companies are increasingly active.

With the aim of increasing competitiveness, economic and social development is very important to support applied research and technology transfer processes to enterprises.

Private equity is a very important tool for reorganizing companies in crisis, giving managerial and economic support to the restructuring processes necessary due to the lack of generational turnover, wrong strategic choices and competitive aggression. It also improves the economic-financial communication of the company.

[9] J. Lerner, *Venture Capital and Private Equity*. A Case-book, New York, 1999.

Information asymmetries alter the conditions of the relationship that is established between company management and those who bring financial resources to the company in various ways. This happens because the investor must make decisions in conditions of greater uncertainty, in the pre-investment phase does not have all the information and, moreover, because the management that has more information could make incorrect use of it with the interest of pursuing personal goals[10].

Adequate economic-financial communication is therefore essential in the eyes of *private equity* investors in SMEs to eliminate information asymmetries and to increase trust in management, so as to assess the return on investments in conditions of less uncertainty and reduce the risk of opportunism on the part of entrepreneurs-managers.

In order to achieve and maintain profitable relations with institutional investors based on exhaustive and satisfactory information from small businesses, there is a tendency to consider the realignment of the corporate information system under various elements of strategic importance: data, information, technical, human and methodological resources. All this implies an adequate business organization in terms of human resources, procedures for data collection and processing, information technology, widespread culture[11].

1.3 A comparison of *private equity* in Italy and the United States

The investment activity in Venture capital is attributable to all the economic systems with flourishing commercial activity and often the first experiences of *private equity* date back to the time of the Roman Empire[12].
It is widely thought that the real emergence of private equity and venture capital investments would date back to events in the United States during the first half of the 1940s.

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[10] P. Demartini, *Superare le asimmetrie informative tra PMI e operatori del private equity*, Economia & Management, Milano, 2002, p. 63
[11] Ibidem
[12] J.S. Levin, *Structuring Venture Capital, Private Equity and Entrepreneurial Transactions*, Chicago 1994 or J. Wiley, *The Business of Investment Banking*, New York, 1999.

In the United States, the first *private equity* firm was the American Research & Development Corporation (ARD), established in 1946 in Boston by Karl Compton[13], Georges Doriot and other important businessman in the area[14].
The company began its activity with a series of high-risk investments in a number of companies born from the development of war technologies linked to the Second World War, which had a large following. It should be pointed out that there was a certain distrust on the part of investors to make their capital available in this nascent business and it is for this reason that the ARD was structured as a closed-end fund with shares subscribed almost exclusively by individuals.
It was only in 1958 that the first venture capital limited partnership was born, one of the legal forms most commonly used today for *private equity* and venture capital activities, characterized by the possibility of obtaining tax benefits and the limited liability of its shareholders.
The partnerships raised capital from qualified investors such as pension funds, banking institutions, insurance companies and industrial groups. In the same year, a very important provision for the launch of venture capital investment activities for young companies was issued, the *Small Business Investment Act* (SBA[15]), which provided for the establishment of Small Business Investment Companies (SBICs), namely privately owned institutions, which included both companies and individuals, regulated by the federal government for the granting of financing and investment policies.
The tax advantages resulting from these operations allowed the development of the program to such an extent that within a few years, 700 existing SBICs were formed, however the excessive regime of subsidies led to the collapse of the mechanisms of the market and in the period from sixties to seventies, the annual contribution in terms of contribution to the sector by private entities was greatly reduced to a few million dollars due to the displacement of the public sector, so the market focused mainly on the financing of start-ups.
At the beginning of the 1980s, the US *private equity and venture capital* market experienced a period of strong development, mainly thanks to the intervention of the US Department of Labour in 1979, which aimed to clarify the rules of the

[13] Ibidem
[14] J. Lerner, *Venture Capital and Private Equity*, op. cit.
[15] Ibidem

Employee Retirement Income Security Act (ERISA[16]), a document that contained the rules for the good management of pension funds. Until that date, investors were not allowed to use resources collected in activities with high risk profiles, such as *private equity*[17].

After the intervention, it was officially recognized as legitimate, thus generating a significant flow of fresh capital to the venture capital market and the relaunch of new limited partnerships to manage capital. The following period is characterized, on the one hand, by the great successes obtained by the American operators and, on the other, by the particular instability of the market. From the point of view of the results obtained by the operators, during the 1980s investment cycles were completed in some of the most considerable technological companies such as Apple Computer, Microsoft and others, and as many buyouts were carried out.

The collection trend recorded conspicuous volumes in the first half of the decade followed by a drastic reduction linked to a decrease in performance. This decrease was majorly determined by factors such as the excessive concentration of the market in some sectors, such as that of computers, the imbalance between demand and supply of financial resources, the high number of new operators entering the market and the consequent increase in transaction prices[18].

In the 1990s, there was a period of greatest growth in the US venture capital sector, mainly due to a couple of factors that allowed the market to overcome the difficulties of the previous period:

- the exit from the sector of incumbents, which eliminated the problem of overcrowding of supply with respect to demand;
- the development of new technologies linked to the IT sector, which has led to new investment opportunities for American operators, consolidating their position as world leaders in this market.

Studies by the National Venture Capital Association have demonstrated the existence of a correlation between investments in risk capital and an increase in GDP achieved in the United States, also thanks to the increase in the number of registered patents.

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[16] L. Ardizzone, *L'esercizio dell'attività di impresa nel private equity*, Egea, Milano, 2018

[17] The legitimacy and significant flow of fresh capital towards the venture capital market and the relaunch of new limited partnerships to manage capital are recognized.

[18] F. Sattin – A. Gervasoni, *Private equity e venture capital. Manuale di investimento nel capitale di rischio,* op. cit., p. 72

The sector with the highest investments is confirmed to be that of software followed by the biotechnology industry and IT service companies. 70% of investments are on start-ups or companies in the early-stage phases and in the first quarter most of the investments were focused on this initial phase of the companies. The American market is much more developed in terms of risk capital than the rest of the world, it is a ready and fast market, where risk capital meets the different needs of unlisted companies, with reduced dimensions.

The contribution that is given is not limited to simple passive financing, that is purely in cash; on the contrary, the venture capitalists have the objective of developing and growing the company. The way in which they seek to achieve this objective is through their contribution of know-how, skills in various areas from strategic marketing to business portfolio planning, working alongside managers and guiding them through their network to allow them to broaden the horizons of the company, without ever forgetting that a company in which a fund is involved also acquires a different image, better in the eyes of the market and banks.

In the last twenty years, venture capital has given a considerable contribution to the American economy in all aspects, from sales to taxation, from exports to job creation, much more respect to public enterprises. It represents an accelerator for innovation because it deliberately focuses on high-risk projects as they operate in the initial starting stages, where sometimes there is only the idea and it is the part of life that is undoubtedly considered too risky for traditional lenders.

Young start-ups need to bring their innovative ideas to the market, innovation in America is the driving force behind the economy but they can't do it alone and this is the key tool to develop their activities in the long run. *Private equity* is the form that has provided capital used to create some of the most innovative and successful companies in recent years, such as Apple, Google, Adobe System, eBay and many others.

In 1980 Steve Jobs was able to support his entrepreneurship through venture capital and his entrepreneurial talent allowed the transformation of basic ideas into projects with highly developed goods and services[19].

Its great success derives above all from the entrepreneurial spirit present in American culture, access also to research and development sources that support the

[19] D. Cagnoni – R. Ippolito - A. Germani – A. D'Ugo, *Private equity e private debt per le PMI. Aspetti operativi, civilistici e fiscali*, Gruppo Sole 24 Ore, Milano, 2017.

company in its initial stages, the use of open markets, infrastructures made available to entrepreneurs, the protection of intellectual property, the willingness and interest of large companies in relation to small companies and a tolerance of failure different from that present in other economies.
However, if a general numerical comparison is made between Italy and the United States, there is a huge difference, since the risk capital market in America is much more developed. Suffice it to say that in Italy in 2015 the level of investments reached 4,620 million euros, in one of the years considered explosive for this instrument in our country, against 5.9 billion dollars in America.
In Italy, much less is invested in start-ups, to be precise, almost a third of what is invested in America. The comparison is not very valid if we consider the extent that the instrument has in this second country considered the mother of risk capital, but we must highlight the operating cost of a start-up in Italy and the United States.
When comparing two countries so different, all aspects must be taken into consideration.
In Italy the development of new ideas is not facilitated by causes such as the bureaucracy of the administrative apparatus, legislation, the type of taxation.
The United States has always been considered as the perfect example of economy, entrepreneurship and innovation where everything is possible and where everything is feasible. This model is very often perceived as an axiom to carry out a real comparison it is necessary to compare the various elements of the American and Italian economy[20].
In America, start-ups are born in a more dynamic environment, in a market completely different from ours where they can achieve forms of development in a shorter time but have higher costs, the mentality of investors is different, the use of bank capital is little used while in our country we depend on it; America is considered the homeland of risk capital and therefore the knowledge of its potential is widespread, which is not the case in Italy.
With reference to Italy, the birth of a specific market of professional operators specialized in the activity of investment in risk capital for companies is conventionally made to coincide with the birth of the first and current trade association, AIFI (initially the *Associazione Italiana delle Finanziarie di Investimento*, then *Associazione Italiana del Private Equity e Venture Capital*).

[20] Ibidem

Before 1986 the Italian law strictly prohibited credit companies from investing directly in the risk capital of non-financial and unlisted companies; only with the resolution of the CICR[21] of February 1987 and the consequent circular of the Bank of Italy of the following month[22], credit companies were also authorised to carry out this activity, while being compliant with specific regulatory constraints. In particular, they were authorised to invest in the risk capital of unlisted companies through the SIF (*Società di Intermediazione Finanziaria* - Financial Intermediation Company) of their issue, which was granted the temporary acquisition of shares, bonds and similar securities of companies, with the constraint of minority shareholding.

In the following years, 16 SIFs were set up, but in fact only a few of them were actively operating. A second event of decisive importance on the regulatory level was the enactment in September 1993 of the Consolidated Law on Banking and Credit[23]: it represented a real revolution in the Italian banking system as it overturned the historical model of formal and functional separation between short-term and medium/long-term credit established in 1936, introducing the universal bank model.

Within this new regulatory and organizational framework, the investment activity in risk capital of unlisted industrial companies carried out by the SIFs belonging to banking groups fell within the scope of the regulations of the Consolidated Law on Banking and Credit, which established precise limitations in this regard[24]; the *ratio* of this regulation consisted in limiting the riskiness of the new universal banks and in the partial preservation of the principle of separation between banks and companies.

In this way, three categories of activity limitation were established:

- an overall limit, which represents the maximum level of investment in participations of non-financial companies as a percentage of the bank's liable equity capital;
- a concentration limit, which sets the maximum percentage of regulatory capital that can be invested in a single investment;

[21] Comitato Interministeriale per il Credito e il Risparmio – Delibera del 6.2.1987

[22] Circolare della Banca d'Italia del 9. 3. 1987

[23] Available on https://www.bancaditalia.it/compiti/vigilanza/intermediari/Testo-Unico-Bancario.pdf

[24] F. Sattin – A. Gervasoni, *Private equity e venture capital. Manuale di investimento nel capitale di rischio,* op. cit., p. 56

- a limit of separation, relating to the maximum amount of the bank's participation in each individual investee company.

Moreover, these limitations varied according to the nature attributed to each credit institution, depending on whether they were ordinary banks and banking groups, qualified banks and banking groups or specialized banks.

The development of the private equity market in Italy is due to the establishment, by Law 344 of 14 August 1993, of closed-end investment funds under Italian law: they represent the main instrument by means of which specialized operators carry out the institutional investment activity in companies' risk capital.

Over the following years and until today, the sector has undergone a continuous and significant evolution of legislation and regulations, as part of the more general structural reforms of the Italian financial system, aimed at increasing its competitiveness in comparison with other financial markets at international level.

A further step forward in Italian legislation is represented by the Consolidated Law on Finance, Testo Unico della Finanza[25] (TUF), through which the regulation of financial intermediation has been completely reformed with the introduction of the institution of the Saving Management Company, Società di Gestione del Risparmio (SGR) and the repeal of Law 344/93.

In the first decade after birth, the sector of institutional investment in risk capital registered the presence of a stable and limited number of operators; the pioneers who began to operate in this sector during the 1980s were some private financial companies consisting of a small number of partners, who began to invest modest amounts of capital in small-medium sized enterprises.

Following the regulatory turnaround of 1987, the banking system also began to invest in the sector, first through SIFs and after 1993 also in a direct way with the creation of special internal divisions.

The first closed-end securities funds under Italian law, on the other hand, began to operate in the mid-1990s, following their establishment. Until that time, the international private equity and venture capital funds operating in the Italian market were very few; later their presence began to become more numerous and stable. It was only at the end of the 1990s that the first significant development of the sector took place in terms of the total number of active operators, coinciding with the

[25] D. Lgs. 24 february 1998, n. 58

boom in the new technology market which, attracting a considerable amount of financial resources, favoured the creation of new operators.
Considering the decade from 2000 to 2010, the number of SGRs headed by *private equity* funds rose from 11 to 68, while operating funds rose from 7 to 126; with reference to the growth in size, at the end of 2000 the total assets of the funds amounted to 580 million euro while at the end of 2010 they amounted to 5.8 billion euro. In addition to the numerical and dimensional growth, in the same period there was also a significant structural evolution of the sector with reference to the nature of the operators: while at the beginning of the new millennium there were mainly bank-issued SGRs, today the majority of those authorized to invest in risk capital is carried out by independent parties, in particular former entrepreneurs and professionals in the sector who have previously worked for large Italian or foreign investors.
From the point of view of the instrument, i.e. the vehicle through which the investment activity is carried out, the most recent trends in the Italian market see an increase in closed-end funds under Italian law and international closed-end funds. This circumstance demonstrates the presence of an important process of operational and institutional alignment of the Italian market with the typical practice of the most recent financial systems.

1.4 The *private equity market*: *facts and trends*

In 2018, 359 transactions were recorded on the Italian *private equity and venture capital* market, distributed over 266 companies, for a total value of €9,788 million, the highest value ever recorded on the Italian market, thanks to numerous transactions dimensions, carried out mainly by international players[26].
Compared to the previous year - 4,938 million euro invested in 311 transactions - the amount invested almost doubled (+98%), while in terms of number of investments the growth was 15%[27].
The types of transactions carried out in 2018 are broken down as follows:

[26] AIFI, *Il mercato italiano del private equità, venture capital e private debt*, 2018, p. 12
[27] Ibidem

- most of the resources were channelled into buyout transactions (€5,242 million);
- secondly, investments in infrastructure (€3,041 million);
- and finally, the expansion segment (€816 million).

In terms of number, with 172 investments made, the early stage was once again in first place, followed by the buyout (109 transactions), while expansion operations were 50.

If we consider the companies involved in the investment, in 2018 we note the presence of 5 transactions with paid-in equity between €150 and €300 million (large deals) and 8 transactions with an amount greater than €300 million (mega deals). Overall, large and mega deals attracted resources of €5,925 million, equal to 61% of the amount invested during the year (€1,598 million, equal to 32%, in 2017, characterized by only 8 large deals and no mega deals).

If we analyse the evolution that has affected the individual market segments, the early stage segment (seed, start up and later stage) has shown significant growth both in terms of the number of transactions, from 133 in 2017 to 172 in 2018, with an increase of 29%, and in the amount invested, from 133 million in 2017 to 324 million in 2018 (+143%).

In 2018, most of the start-up operations were carried out by private domestic operators focused on early stage, which carried out 58% of the investments in this sector, followed by international operators (22%).

During 2018, 816 million euros were invested in the expansion segment, distributed over 50 transactions. Compared to the previous year, the figures are up 11% in terms of number and 142% in terms of amount, thanks to a transaction of significant size.[28]

From the geographical distribution of investments, it emerges how, in line with the data recorded the previous year, 92% of the investments made in 2018 concerned companies located in our country, corresponding to almost the entire amount invested in the year.

If we consider only the activities carried out in Italy, the number of operations involved companies located in the North of the country with 76%, followed by the Centre with 13% (17% the previous year), while the regions of the South and

[28] KPMG, Sustainable Returns, Italian Private Equity and Venture. Capital Market: 2017 performance, 2017

Islands weighed for 11% (9% in 2017). In terms of amount, however, the North attracted 83% of the total resources invested in Italy, followed by the Central regions with 14%, while the share of resources allocated to Southern Italy remains still reduced (3%). The record is in the Lombardy region, where 44% of the total number of transactions completed in Italy in 2018 was carried out, followed by Emilia Romagna (10%) and Veneto (8%). In terms of amount, Lombardy ranked first, with 45% of the total resources invested, followed by Piedmont (19%) and Lazio (13%). There are three regions in which private equity and venture capital transactions were not recorded during 2018: Calabria, Molise and Valle d'Aosta.

In 2018, the ICT sector (communications, computers and electronics) represented the main investment target in terms of number of transactions, with a share of 18%, followed by the industrial goods and services sector with a weight of 15%, and from the medical sector (12%).

In terms of amount, most of the resources invested during the year were transferred to the transport sector (19% of the total), thanks to some large-scale operations, followed shortly after by ICT (just under 19%) and from the industrial goods and services sector (16%).

With regard to companies operating in high technology sectors, the number of transactions carried out in favour of companies defined as "high tech" stood at 131 in 2018, with an incidence on the total number of operations of 36%.

In detail, the sub-sectors with the highest number of transactions are those in the medical, ICT and biotechnology sectors, which, in terms of number, accounted for 70% of the investments in high-tech companies made in 2018. It is important to note that 85% of the detected high-tech operations surveyed involved companies during the initial stage, characterized by a significantly lower average investment cut compared to other market segments.

With regard to the distribution of the number of investments by size of the target companies, the data of 2018 show a concentration of operations on small and medium sized companies (80% of the total number, same weight as in 2017), characterized nu a number of employees lower that 250 units[29].

These companies attracted resources for a total amount of 2,342 million Euros (24% of the total, 44% in 2017), while the rest of the market, with a weight of 20% in

[29] Available on www.aifi.it

terms of number of investments, absorbed 76% of the total resources (€ 7,446 million).
The distribution of investments by classes of turnover of the target companies also shows that small and medium sized companies (with a turnover of less than 50 million Euros), despite having attracted resources for about 20% of the total, represent, also for 2018, the main target to which private equity and venture capital investments in Italy are directed, with a share of 72% of the total number of transactions.

Chapter 2

The world of Family Businesses

Overview: 2.1 The *family business* governance system. 2.2 The generational succession: strengths and weaknesses. 2.3 Value creation in the *family business* model. 2.4 The financial structure in the *family business.*

This chapter examines the motivation for which *family businesses* have always aroused a strong interest because of its characteristics and its ability to proliferate in very different environments. These entities have become the real backbone of the Italian entrepreneurial system and for this reason it is interesting to understand the challenges they face to ensure their continuity over time and their economic growth. The analysis carried out is centred on the role of *family businesses* in the Italian entrepreneurial fabric and on the means they use to face critical moments such as generational turnover.

2.1 The *family business* governance system

A *family business* is an enterprise in which a family, for at least two generations, has held a share of the shares or capital and forms part of the top management[30].
The generational succession represents a particularly complex problem from the plurality of objective situations, referring to the characteristics of size and organization of companies and subjective, referring not only to the plurality of subjects, but also to their specific training and the different interest that potential successors may have in respect of the company.
The notion of a *family business* covers all the companies managed individually or collectively, whose ownership is family-based or, if exercised as a company, whose control can be traced back to a family.
The distinctive character of the family business, common to all its development phases, is the link between the family and the business, which is the economic and patrimonial identification of the founder in the formation and initial development

[30] Alcorn, P.B., *Success and survival in the family-owned firm*. McGraw-Hill, New York, 1982

phase, and which is perpetuated between the members of the family or of the families also in the subsequent generational passages[31].

From a legal point of view, in the generational transfer, the successor is not the one who simply receives the capital goods as an inheritance, but is the one who takes over from the giver in his role as an entrepreneur and this makes the process legally difficult by having to adopt tools and solutions that allow to safeguard the company, since the simple rules of succession could lead themselves to the crisis of the company[32].

There are several institutes that respond to different needs related to both the family situation and the dimensional aspect of the company to be transferred and, in addition, highlight strengths and disadvantages to be assessed with reference to the specific situation, the **family holding company**: the transfer of the shareholding to the plurality of heirs can determine a fractionation such as to make its control problematic. In fact, the insufficiency of the company's assets in the face of the expectations of the mass of heirs can create situations of family conflict that could undermine the cohesion of the group that holds the majority shareholding. One solution is to set up a holding company with the simultaneous creation of several ad hoc companies based on the number of heirs. The armouring of control through the creation of the holding company must be pursued in the medium to long term, with the inclusion of withdrawal clauses in favour of the shareholders who intend to sell and pre-emption clauses in favour of other members of the family group[33].

A critical element of the instrument in question is represented by the financing methods of the dimensional development, which may require interventions such as to undermine the original set up of the structure. In fact, the financial requirements can be satisfied either through self-financing and the recourse to this form cannot disregard the level of profitability and the orientation of the partners with regard to the distribution of profits, or with indebtedness that normally requires the release of personal guarantees or, finally, with an increase in capital subscribed by family members or by third parties. The last decision carries the risk of losing control of the group. Taking into account the main advantages of the establishment of the family holding company, it is necessary to verify that:

[31] Azzone, G. - Bertelè, U., *L'Impresa. Sistemi di governo, valutazione e controllo*. Etas, Milano, 2004.
[32] Corbetta, G. - Dematté, C., *I processi di transizione delle imprese familiari.* Mediocredito Lombardo (Studi e ricerche), 1993.
[33] Corbetta, G. - Preti, P, *La successione nelle imprese familiari*. Economia e Management, 2, 123-139, 1988.

- the holding company makes it possible to settle family matters in a different field from the operating companies,
- the conflict of interests between operational shareholders and is not managed by the governance of the holding company,
- the rationalization of the distribution of profits to the subsidiaries where the children operate downstream is achieved, there is the possibility of using intra-group financial instruments,
- in the holding company, the taxation of dividends is levied on a taxable amount equal to 5% of the dividends received.

The main disadvantages of setting up the holding company are:

- the obligation to prepare the consolidated financial statements of the group, the holding company involves a duplication of corporate and administrative costs;
- in the case of intra-group loans, interest income is taxed on the basis of IRAP for the holding company, while interest expense for operating companies is not deductible on the basis of IRAP;
- the holding company mainly carries out transactions exempt for VAT purposes and therefore loses part of the VAT credit on the basis of the deductibility pro rata and the redistribution of the holding company's dividends to individuals requires a further step that is subject to taxation, albeit limited (12.5 per cent by way of tax in the case of non-qualified shareholdings, ordinary taxation on 40 per cent of the same dividends in the case of qualified shareholdings);

limited partnership: with this operation, the entrepreneur becomes a limited partner, obtaining the possibility of closely monitoring the fortunes of the company while remaining outside the management, but maintaining ownership. At the same time, he can allow children who are not interested in the management to also assume the role of limited partners entitled to the distribution of profits[34];

donation: a very frequently used instrument, also in view of a particularly favourable tax regime. In fact, for the purposes of income tax, the transfer of a company by free act does not constitute taxable realization of the capital gain related to the company itself, while, for the purposes of indirect taxes, the legislation

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[34] Montemerlo, D., *Il governo delle imprese familiari. Modelli e strumenti per gestire i rapporti tra proprietà e impresa.* Egea, Milano, 2000.

on the donation of business discounts the registration tax only in case of donation to persons other than the spouse, relatives in a straight line and other relatives up to the fourth degree[35]. The use of donation, however, meets the limit of the civil law designed to protect the legitimate. In order to overcome this obstacle, we have often witnessed the stipulation of a bundle of donations in favour of all the legitimate ones for the purpose of equalizing their rights; but also this solution does not avoid the risk of reduction actions connected to the change in the value of the company recorded at the time of the opening of the succession.
In some cases, it has been preferred to resort to a donation of the company in undivided shares corresponding to the legitimate rights with simultaneous transfer, for consideration, of the shares of the legitimate donors to the chosen recipient for the continuation of the company. However, this modus operandi is not very effective, as it is quite clear that these transfers remain, however, exposed to the action of reduction as they disguise real donations;
family buy out: represents a "family" variant of *leveraged buyout* or *management buyout*, an operation that allows the acquisition of a company or its control package through the use of bank debt, with the final allocation of the debt itself among the liabilities of the acquired company[36]. This operation is used to resolve disputes that have arisen between family members with entrepreneurial functions or to allow a family branch to acquire a controlling stake in a very fragmented shareholding structure. There are a number of variations to this operation, such as when the bank considers entering directly into the capital of the family business;
trust: introduced in Italy by Law No. 364 of 16 October 1989, ratified starting from 21 February 1990, represents a fiduciary relationship deriving from private will, where those who hold the ownership of certain assets or rights is required to keep and administer them or, in any case, to use them for the benefit of one or more beneficiaries or a specific purpose. Recourse to the trust, by achieving the segregation of the assets entrusted to the *trustee*, ensures the possibility that they maintain their substantial unity and are intended for the purpose. In this way,

[35] Ibidem
[36] The phases of this operation can be briefly described as follows: the heir designated for the continuation of the company that does not have the financial means necessary for the acquisition of the family company or the controlling interest, establishes a new company (so-called newco or new company) that stipulates a bank loan for the acquisition of the shares of the company to be acquired (so-called target). This loan is usually guaranteed by a simultaneous pledge of the shares of the newco. The newco incorporates the target company that will remain exposed to the bank for the repayment of the loan itself.

various objectives are achieved, such as the non-aggressiveness of assets by creditors and a lower cost and greater flexibility compared to the use of a foundation under the Italian law. As far as the limits deriving from civil law are concerned, the *trust* allows for the achievement of results that would be difficult to achieve through other instruments such as pacts or agreements for successors or substitutes that should allow to overcome some civil foreclosures such as the prohibition of agreements as to succession, but leave room for wide interpretation and application doubts;

shareholders' agreement consists of an agreement between the collateral shareholders to the memorandum of association, to be stipulated both at the time of incorporation of the company, and at a later date, with which it is intended to regulate the conduct of all or part of the shareholders. With the reform of company law, the regulation of such agreements, dictated by the Articles 2341 bis and ter of the Italian Civil Code, applies to all types of S.p.A. (closed, open, listed and unlisted). Through the shareholders' agreements, the entrepreneur can arm his own choices of succession policy but cannot exceed the limits imposed by civil law in relation to the rights of the legitimate and the inalienability of the same;

family pact: with law no. 55 of 14 February 2006 (family pact), the choices of the entrepreneur in relation to generational succession are freed from the limits imposed by civil law. With the new provisions, in fact, the entrepreneur is allowed to plan the generational transition in time, guaranteeing the future functionality of the company through a targeted choice of his successor without having to make the reasons clear[37]. The need for a legislative intervention aimed at providing appropriate instruments to facilitate the succession in the small and medium enterprises for the purpose of ensuring their survival has, for a long time, been the object of specific interest on the part of the Community bodies, aware of the centrality of the problem for the conservation of the productive structure of the Member States.

In particular, the Recommendation of the European Commission dates back to 7 December 1994, inviting Member States to facilitate the succession of a company by modifying the legal system into a coordinated set of corporate and tax rules aimed at guaranteeing its continuity. In particular, Recommendation 94/1069 CE concerning the succession of small and medium-sized enterprises highlighted the

[37] Lupetti M.C., *Patti di famiglia per l'impresa*, a cura della Fondazione italiana per il notariato, 2006.

phase of the generational change as a crucial phase in the life of the same in view of its negative repercussions on the economic system, as well as on creditors and workers[38].

2.2 The generational succession: strengths and weaknesses

The generational succession at the head of the companies is assuming a problematic relevance of great interest. Ensuring continuity in the company's action means making decisions, like strategic, organisational, financial and technological decisions, also with regard to the generational turnover at the top of the company. Especially in the case of small companies, the moment of entrepreneurial succession represents a crucial passage in the development of the company and a privileged opportunity to observe and analyze specific strategic and organizational needs of that company[39].

In recent years, succession has also become the subject of reflection by entrepreneurs and scholars in Italy and it is very reductive to address the problem of entrepreneurial succession only in relation to the characteristics and consequent problems of the people involved, as if the scene on which this handover takes place, the company, played a purely passive role[40].

In reality, an effective succession process begins with the conviction, constantly practiced by the entrepreneur, of the need to ensure continuity over time to the company even beyond his stay. In short, therefore, to pass the hand also means and above all to know and plan the future business development and prepare the integration of young people in consistent terms. Only in this way is it possible to have an objective basis of reference on which to base a generational comparison, training, progressive delegation of responsibilities and decision making.

[38] The Recommendation did not fail to highlight the critical points that hindered the succession of a company, such as the inadequacy of the legislation of the Member States in the field of company law, succession and taxation, the need to raise awareness of entrepreneurs on the specific subject, in order to induce them to plan their succession properly, problems related to the tacit acceptance of coheirs in the absence of appropriate forms of financing, the absence in some Member States of legal instruments enabling the transformation of the corporate form, without having to dissolve the existing company and set up a new, onerous inheritance tax and, more generally, a tax regime which often penalises the adoption of a new corporate form more suited to the success of the inheritance and a finding that death or certain unilateral acts such as withdrawal may be incompatible with the social contract and lead to the liquidation of the company.

[39] Costa G., Nacamulli C.D., *Manuale di organizzazione aziendale vol. 3*, Utet, Milano, 1996, p. 197

[40] Panato A., *Passaggio generazionale nelle aziende familiari: le regole da seguire*, marzo 2014.

However, there is no univocal solution, but rather different approaches that are more or less effective depending on the level of management of the company and the distribution of ownership shares among family members. There are different approaches to generational succession:

conservative approach: when putting the family above everything else. This approach leads to the identification of the successor within the family, choosing the one who enjoys the consent and legitimacy of all relatives. Business dynamics are seen as a boundary condition, facilitating or hindering the pursuit of the family's objectives.

It is an approach that is on the verge of extinction but that can still undermine the fate of family businesses, especially if they are small in size;

pragmatic approach: it is focused on the needs of the business. All decisions relating to succession are made on the basis of the value and survival of the enterprise. It is a more modern approach to face the process, but it is not risk-free, because, even if the new leader is the person with the most suitable portfolio of skills, he could, however, be rejected by the organization;

anticipators' approach: who, even before starting the succession, introduce more formalized operating procedures and management systems, loosening in time the identification of the company with the entrepreneur, and in this way prepare the organization to deal with the change of leadership in a less traumatic way[41].

approach of the far-sighted: who manage to plan the succession in a flexible way, having a clear direction in which to move and are ready to change course when the external or internal dynamics generate new opportunities.

Therefore, they create governance structures that support strategic decision-making processes, including the one that leads to the choice of the most capable successors in terms of managerial and relational skills. Even in family businesses, despite their small size, it is now understood that thinking as an "owner" is not like thinking as a "manager" and that even these business realities must be brought into the "hands of those who know"[42].

In family businesses, in fact, the allocation of control is not always efficient and this is mainly due to the lack of awareness that managerial skills and entrepreneurial attitude are not necessarily passed on to children based on the profession carried

[41] Pasqualini C., *Passaggio generazionale*, Cesi Professionale, 2008, p. 35

[42] Ibidem

out by the parents, thus persisting to seek successor in the family circle or among the most trusted employees, instead of going to the external labour market. This is also considering that, when errors in the management of the transfer of leadership lead to the decline of the business, the damage is not only for the family owner but for the company as a whole and for all stakeholders.

It is therefore necessary to plan well in advance the process that may take a fairly long time, so that the successor can develop in the best possible way the characteristics necessary to perform its entrepreneurial role. It is important to also take into account the fact that, in most cases, the transfer of business management from one generation to another is seen strategically as a moment of relaunch.

One of the weaknesses of family businesses is usually represented by the organization chart. At an organizational level, in fact, there are often distortions in the definition of the roles and functions covered within the company organizational charts, exacerbated by the presence of fathers, mothers and sons in the pre-eminent sectors or at the head of the strategic company functions.

The organization chart of the family business, therefore, maintains a vertical approach, whereby the father takes on the role of Chief Executive Officer (CEO) with a high propensity to conduct the business. The mother, when involved in the company, is usually relegated to part of the administrative management, always under the supervision of her husband, while the children are reserved for the roles of commercial or marketing in the most advanced organizations.

This phenomenon leads to a series of extremely negative consequences in terms of organizational optimization, namely:

- invalidation of the family meritocratic system, as the presence of children would not fail even if they did not demonstrate particular entrepreneurial skills and consequent devaluation of deserving business figures;
- the result of an incomplete flow of information from the family to the staff, aimed at protecting a hypothetical area of confidentiality[43].

[43] Costa G., Nacamulli C.D., *Manuale di organizzazione aziendale vol. 3*, op. cit., p. 200.

2.3 Value creation in the *family business* model

The processes of economic globalization, the international opening of markets and the advent of new process and product technologies have meant that, today, efficient and effective management and greater awareness and adaptation to the changing environment represent the watershed between the winning family businesses and those, instead, destined to leave the market.

To create value, in the phases of generational change that characterize every business reality, the people who, respectively, take over and leave the company, are often in different phases of their life cycle with regard to success and satisfaction. In particular, there can be major differences between the person leaving the business and the person taking over, in terms of values and lifestyles, which can affect both the transfer of business and the future organisation. In this perspective, the problem of choosing a successor is crucial[44].

The competitive advantage, understood as the company's ability to occupy a favourable position in the market in which it operates, is not, in fact, a stable factor over time, so once achieved it does not remain so[45]. This position of superiority can, therefore, be threatened by changes in the market that can change the factors of success and by the action of competitors.

Over the years, the progressive affirmation of the global dimension of the market has forced family businesses to adopt a vision that is also necessarily global. The idea was therefore developed that an internationalization strategy would be adequate to compete in the current context.

This strategy, in fact, allows the acquisition of new resources, the development of one's own wealth of knowledge and the strengthening of one's own reputation. This has led to the development of the so-called make-together collaborations, which include joint ventures, commercial partnerships and business networks that are aimed at sharing knowledge and synergistic skills and lowering transaction costs related to the entry into a new market[46].

In the panorama thus outlined, it is worth pointing out that small and medium-sized family businesses have specific strengths and weaknesses and many of the

[44] Guatri L., *La teoria di creazione di valore. Una via europea*, Egea, Milano, 1991.
[45] Corbetta G., "*Le imprese familiari: un ambito di lavoro promettente per l'economia aziendale*", in AIDEA, Dinamiche di sviluppo e internazionalizzazione delle *family business*, Il Mulino, Bologna, 2008.
[46] Ibidem

traditional problems they face, such as lack of funding, difficulties in exploiting technology, limited managerial skills, low productivity, regulatory constraints and generational changes, are aggravated in a globalised system and in an environment dominated by technology.

It is therefore essential for this type of company to improve their ability to collect information, enhance their technological support and, above all, increase their managerial skills[47].

The vitality of entrepreneurial activity is, in fact, fundamental for the development of *family business*. Entrepreneurs are those who know how to seize opportunities, determine economic dynamics from birth to development, up to the crisis and decline of the company and take the risks. In each country, social, cultural and political factors influence not only the availability of business opportunities, but also the ability to take such risks and the mobility of resources.

Factors hampering entrepreneurship include the level of education and training, as well as institutional rules and obstacles that discourage the creation of new businesses, but also the expansion of existing activities. The change in the balance of the world market, the new technologies and the importance of network structures also require skills that young entrepreneurs in particular have the opportunity to acquire and which are far away from many founding fathers. The first and second generations of entrepreneurs need to find a balance between the stability of the company's tradition and the new ways of doing business that can guarantee its survival today. Therefore, in a constantly changing context, also the awareness about the criticality of the generational shift and its proper planning is an opportunity that allow family business to compete on a global market scale[48].

In the case of a family business, the new management almost always coincides with the new generation. In particular, in the generational shift, it can happen that only one of the heirs emerges and that, therefore, the new management is reduced to him or that, on the contrary, all the shareholders and, that is, for example, all the brothers and all the cousins, contribute to form the new management team.

In both cases, in order to create value and ensure the survival of the company at the transition, it is necessary that the new management contributes to the development

[47] Sicoli, G., *Un'analisi delle relazioni tra creazione di valore e gestione aziendale*, Franco Angeli, Milano, 2008, p. 67

[48] Ibidem

of new strategies, improves the formal mechanisms of management and provides for the training of new company executives[49].

In the presence of an optimal situation, the new management should take office with the full support of the old generation that has "prepared the ground" for it. In many cases, however, the new management is not simply faced with the need to continue the task of professionalizing the company and adapting strategies to the current context in which it operates but is faced with the need to address these issues ex novo. In these cases, when collaborating with the outgoing generation, successors may face an obstacle created by the exponents of the old management, who insist on maintaining the status quo while projecting their shadow on the successors. This, obviously, makes it difficult for the latter to assert their personality[50].

The difficulties, moreover, increase when the new leaders find themselves forced to integrate the new strategies with the old ones, without being able to abandon the latter completely. New executives, in fact, usually find themselves running a company that, since its foundation, has probably become larger, more complex and more formal and, in most cases, in family businesses, only new executives are able to cope with these problems. The first generation has generally used instinctive entrepreneurial strategies that simply responded to the need to survive; the new management, on the contrary, must be able to make use of consciously planned management criteria and oriented to the creation of value. For this reason, future heirs of the company must be taught, from their childhood until they reach the age of majority, a whole series of values relating to the importance of entrepreneurial challenges and, such teachings, can only be imparted by the family. Future heirs generally develop their skills and self-confidence through university education and by doing small jobs outside their family business. They thus enter the company and for the first four or five years they socialize with the company's practices and learn to make decisions. At this point they are able to take responsibility for one or more profit centres, so as to also acquire management skills. Adequate training therefore prepares the heir for managerial tasks, helping to simplify the generational transition. An adequate training plan should, therefore, provide the necessary skills for the management of the company, help develop their identity and acquire

[49] Piantoni, G., *La successione familiare in azienda. Continuità dell'impresa e ricambio generazionale*. Etas, Milano, 1990.

[50] Ibidem

managerial skills. These skills should allow the new generation to be able to manage a profit centre, develop the organizational aspects of the company, identify the objectives and the necessary external collaborations, without neglecting the possibility that all these skills, acquired by successors, can be complementary to those of the parents entrepreneur[51].

The future heirs may, in fact, even at a later date, try to test most of these skills on their own initiative even if, for some of them, such as the management of a profit centre, will still be necessary the authorization of the outgoing generation. The heirs, in fact, should try to develop skills that cover areas neglected by parents and avoid the creation of conflicts by operating in areas complementary to those of traditional competence of the parent entrepreneur, rather than compete with this. The founders have, in most cases, managed their company in an informal way and through daily practice. In this way they find it difficult to delegate part of their authority and responsibility for the achievement of objectives that are difficult to identify. It is precisely within these areas of intervention, little known to the old management, that the attention and action of the heir should be concentrated, helping to provide the company with skills that it is likely to have an extreme need for, either by taking direct responsibility for these issues or by availing itself of the collaboration of more experienced people. The areas in which the heir can operate include, in detail, the analysis of the market segment, the measurement of the effectiveness of individual business divisions, cost analysis, management of the warehouse, forecasts, training of human resources, corporate communications with the implementation of integrated information systems and the preparation of financial statements and budgets relating to both current management, the financial situation and strategic developments. It should be emphasized that heirs can also offer original contributions, overcoming the traditional operating methods of the company and seeking growth and profit opportunities in the markets for the future. Usually, in fact, the founders, when they have reached a certain "managerial maturity", no longer maintain direct contact with customers and no longer closely follow strategies put in place by the competition[52].

[51] Porter M., *La strategia competitiva*, Compositori Ed., Bologna, 1997
[52]Tomaselli, S., *Longevità e sviluppo delle imprese familiari. Problemi, strategie e strutture di governo*. Giuffrè, Milano, 1996

As a result, they may have lost the sensitivity necessary to perceive market developments. The heirs, who take charge of this area of intervention, should try to understand how the company is perceived and what changes are necessary by formulating new business ideas through which they can increase business profits. Even if, in all probability, they will not be able to realize their ideas immediately, they will acquire, however, the ability to perceive the market as well as to manage the company in a strategic perspective and laying the foundations for the creation of a competitive advantage that can create value for the company and ensure its survival over time.

In the process of generational succession, it is first of all necessary to try to introduce elements of rational decision-making, trying to separate the business reality from the familiar one, however, always in respect of the values and expectations of the latter[53]. If the main objective of succession is the continuity of the business, it is therefore necessary to implement a planning process that helps the entrepreneur and his family members to rationalize the future they want for themselves and for the company, through a series of measures to be implemented progressively and that will affect both the family and the corporate situation, whose aspects inevitably intertwine and condition each other. Not planning can mean, in fact, having to face the development of the business without adequate management tools and even the possibility of having to face and manage conflicts of interest among family members, corporate organizational tensions and inefficiencies, higher costs and scarcity of financial resources, which could seriously compromise the continuity of the business at the time of the need for succession. Planning, on the other hand, although it does not completely eliminating the risks of failure, allows at least a series of concrete decisions and actions to be substituted for an uncertain scenario and to face the generational shift with the same strategic planning model used to deal with and manage ordinary business events.

The different types of family businesses imply an equally vast number of solutions that can be adopted for an effective generational succession, but the common element of these tools is the need for succession planning through the configuration of coherent paths that involve both the business and the family. In other words, while starting from the awareness that the succession of the family business is influenced by an infinite number of variables and that it is a long, complex and non-

[53] Ibidem

standardisable process, it is still essential to draw up guidelines to help grasp the problems, formulate possible alternatives, choose the one that best meets the specific needs and plan the necessary interventions to achieve it[54]. From this point of view, it is opportune that the planning does not develop along a single and irreversible objective to be pursued, but it is preferable that it is able to adapt and redefine itself in the light of the events that arise from time to time. The planning process should therefore outline the future reference framework for the family and for the company and at the same time be sufficiently flexible and able to adapt to the dynamics of the context[55].

2.4 The financial structure in the *family business*

The generational shift is a particularly delicate moment in the life of a company because it inevitably involves its economic and financial aspects as well. Worthy of importance is the financial aspect, especially with reference to the relationships that the company has maintained, during its life, with the banks of reference[56]. Bank branches have systematically been a point of reference for family businesses, supporting their development and growth by providing them with means and advice, which in most cases has become personal and confidential at the same time. In relation to the changes underway, this relationship may also undergo changes and assume a more formal character; however, this should be done gradually and with the necessary preparation. This is also because in our country there is not yet an evolved tradition of merchant banking, i.e. there are few financial institutions that play an effective role of participation in the financial management of the company without short-term speculative objectives[57]. The changed market conditions are, in fact, underlining the inability of the Italian productive system to compete adequately with other systems, given the low propensity to innovation, the inadequacy of the productive capacity and the difficulty to compete in markets other than the national one. These difficulties are connected, above all, to the question of access to information, to the complexity and not complete homogeneity of the regulations and to the onerousness of the administrative procedures.

[54] Piantoni, G. *La successione familiare in azienda. Continuità dell'impresa e ricambio generazionale,* op.cit. p. 46.
[55] Porter M., *La strategia competitiva*, op.cit., p. 58.
[56] Costa G., Nacamulli C.D., *Manuale di organizzazione aziendale vol. 3*, op. cit., p. 205.
[57] Ibidem

In family businesses, one of the most widespread phenomena is the inadequacy of risk capital with respect to the real economic and corporate needs, which causes financial instability as well as lack of credibility towards business interlocutors such as banks and other financial subjects. This pathology is manifested and is evident through the reading of the balance sheet items as well as by comparing economic and asset values and evaluating their trend from one year to the next, through analysis by correlation indexes or other monitoring tools.

From a strictly financial point of view, there are problems that can generate tensions within the company, such as "confusion" between the entrepreneur's personal finance and the company's finance, constant reliance on credit institutions, permanent lack of liquidity (time lag in the collection of credit and debt payment or the absence of a univocal and constant behavioural approach in the management of credits and debits), structural and organizational oversizing with respect to the ability to generate business profitability, practice of commercial policies aligned with the market, but not with respect to the need to cover fixed costs (an increase in prices would result in an exit from the market) and management of dispersive and not related inventories with the respect to the demands coming from the market outlet.

In case of generational changeover, the incoming team, in order to remedy the problems described above and, in particular, the permanent lack of liquidity, must first of all identify and initiate systems to remove the causes underlying this inefficiency and provide for the introduction of financial resources in order to limit the spread of the phenomenon.

Family businesses, in choosing the financial structure of their company, given the non-diversified nature of their participation and their desire for the survival of the company, have strong incentives to minimize the business risk. As mentioned above, families may have different interests than minority shareholders as the family is interested in issues such as the stability and capital maintenance.

The founding families see their businesses as an asset, a good to be passed on to family members or their descendants, rather than a wealth to be consumed during their lives[58]. For them, the survival of the business is a fundamental issue and,

[58] Anderson R.C., Reeb D.M, "*Founding-family ownership and family performance: evidence from the S&P 500*", The Journal of Finance, vol. 58, n. 3, p. 1302-1328, 2003.

therefore, they will seek risk reduction strategies through diversification or forms of capital with low default.

Family businesses can mitigate business risk by employing forms of financing with a low probability of default, which therefore suggests a greater dependence on equity financing in the capital structure[59]. Several empirical studies have concluded that family businesses employ significantly lower levels of debt in their capital structure than nonfamily businesses for the following reasons:

- ownership concentration is positively related to leverage and reduces the agency cost of free cash flows. In this way, it is possible to create greater levels of available flows in the family business, allowing the company to rely less on debt as a form of financing[60];
- rejection by the family business of the possibility of sharing control of the business with external partners and adoption of highly conservative strategies;
- preference of family businesses for less risky options because an increase in debt makes it more likely that they will lose family control and because the failure of the business involves not only a loss of personal wealth, but also of family human capital. In fact, the greater risk aversion of FBs is due to the possible effects that they may suffer both in terms of assets and the image and reputation of the family, as a result of the failure or bankruptcy of the company;
- poor predisposition to grant collateral and/or personal guarantees, which makes access to credit more difficult;
- family member participation in management: as families can exercise their control and influence also through participation in the position of CEOs and/or by maintaining a disproportionate representation on the Board of Directors, the lower leverage will be greater when the family member's control exceeds property rights or when a family member holds the position of CEO.

[59] Ibidem

[60] Jensen M., Meckling W.H., "*The theory of the firm: managerial behavior, agency costs and ownership* structure", Journal of Financial Economics, vol. 3, n. 4, p. 305-360, 1976.

Some authors, on the other hand, are in favour of greater recourse to indebtedness by family businesses, which justify these conclusions by means of:[61]

- the willingness to maintain firm control of the company leads to preferring debt to avoid dilution of the ownership share, if the resources generated internally are insufficient to cover the necessary needs of the business and assuming the adoption of a valid strategy of hierarchy of sources. Such reluctance of family members to open up the capital of the business, which positively influences the opinion on the usefulness of debt financing, is more likely to occur the closer the personal wealth constraints of family members (which could prevent further venture capital investments) and the smaller the businesses are in size (as the willingness to maintain control within the family is greater as the business is seen as an integral part of family assets to be passed on to heirs);
- as the number of generations increases, family members are less "overinvested" in the enterprise and are more willing to use the debt and bear the consequent risk for their individual wealth, consequently the use of the debt is favoured by the dispersion of property across generations.

In fact, the proliferation of roles over the generations favours the divergence of interests and information asymmetry with the consequence that family members who do not manage the company will put pressure on the increase in indebtedness as debt is a governance mechanism that reduces managerial opportunism[62].

Furthermore, the entry of the new generations into the enterprise will be more difficult for the family business to balance the disadvantages of operating on a small scale with the advantages of the agency costs of managing the resources efficiently. It will therefore be necessary to increase the capital investment to favour the accumulation of resources and to compete on the same scale as the nonfamily businesses and, in these cases, debt is preferred to new equity brought by non-family members.

In fact, in first-generation family businesses, the limited financial structure reflects the founder's desire to retain control of the business, but hinders the future

[61] Schulze W.S., Lubatkin M.H., Dino R.N., "*Toward a theory of agency and altruism in family firms*", Journal of Business Venturing, vol. 18, n. 4, p. 473-490, 2003.
[62] Costa G., Nacamulli C.D., *Manuale di organizzazione aziendale vol. 3*, op. cit., p. 209.

capitalization and growth of the business: unless the family has a large fortune, the contributions of family members are most likely lower than those of other potential shareholders (financial institutions, non-financial companies, individuals).

In order to avoid the entry of such minority shareholders, family businesses prefer to increase their indebtedness.

Finally, some results lead to the conclusion that family ownership does not have a significant influence on the financial structure, such as the study by Anderson and Reeb who, with regard to leverage, state that family ownership has little effect on the capital structure choices of family businesses[63].

A possible explanation is that families, being able to maintain low-risk holdings in businesses, have less need to engage in risk reduction activities. Analyzing the financial structure of family businesses, it is necessary to stress a peculiar aspect, namely "the family nature of business", that leads the family business to behave in a significantly different way in terms of financing compared to nonfamily businesses: as indicated in the literature, even if not unanimously, there are significant differences in the financial policy of family businesses and nonfamily businesses, so much so as to speak about the "peculiar financial logic" of family businesses[64].

The interaction between family and business finances seems to support the conclusion that family businesses, being reluctant to open up capital to non-family members, prefer family equity and therefore internal to the company, with the consequence that family business owners usually reinvest their funds[65].

Precisely because of this reluctance, FBs, compared to other companies, could be penalized, in the management of internal resources, by the cultural closure of the entrepreneur towards the entry of new partners and towards access to securities markets, in which to collect and raise financial resources at title of risk capital.

Consequently, the use of internal sources within the family business is mainly based on[66]:

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[63] Anderson, R. C., & Reeb, D. M., *"Founding-family ownership and firm performance: Evidence from the S&P 500"*. The Journal of Finance, 58(3), 1301–1327, 2003.

[64] Ibidem

[65] Ward, J. L., "*Perpetuating the family business: 50 lessons learned from long-lasting successful families in business*". Palgrave Macmillan, New York, 2004.

[66] Sicoli, G., *Un'analisi delle relazioni tra creazione di valore e gestione aziendale, op.cit.,* p. 77.

a) self-financing, but often the number of companies able to generate profits such as to rebalance the financial structure of the company is increasingly limited;
b) the contribution of new risk capital by the family: this occurs when the need for corporate restructuring becomes necessary and decisive for the success of the company and appears to be the only solution, the last "weapon" against the involvement of third parties in risk capital;
c) contribution of risk capital through the transfer of part of the family assets outside the company, significantly influenced, in addition to the size of the assets, especially by the attitudes and propensities of the entrepreneur-family.

Moreover, in the analysis of the sources of financing used throughout their life cycle, it emerges that in the case of FB it is necessary to consider that, in addition to the classic sources of financing, these companies can also resort to the so-called "*family and friends financing*" (FFF), or debt-related resources that come directly from family members, friends and other informal sources. There are divergent studies on the efficient or non-efficient use of these sources by FBs: some studies argue that overlapping family and business finances can create inefficiencies.

Another part of the literature, on the other hand, is for efficiency, such as Haynes, Walker, Rowe, Hong (1999), who conclude that family businesses use available resources efficiently by developing strategies that link family capital to business[67].

Some studies introduce the concept of *familiness* that derives from the integration of family and business life, deriving from this concept the competitive advantages of the company, including with regard to financial resources, the commitment of relations with stakeholders, patient capital and parsimony in poor environments.

Familiness can create a particular form of capital, family capital, which can act as a resource that generates sustainable competitive advantage.

Family capital has the property of being unique to the family that generated it and can well satisfy the criteria of being precious, rare, difficult to imitate and not replaceable and, like social capital, it is not located in the actors themselves, but in the relationships between each one[68]. Some scholars suggest that *familiness* and *family capital* can compensate not only for the weakness of human and financial

[67] Lindow C. M, *A strategic fit perspective on family firm performance*, Springer Gabler, 2013
[68] Ibidem

capital in family businesses, but also agency issues that are specific to family businesses, such as opportunism, altruism, honest incompetence.
Recent studies on family business suggest that processes regarding the financial structure and financing decisions are influenced by several factors: in many cases decisions made by owner-managers about financial structure take into account a conglomeration of competing management, family, economic, market, and industry considerations.
Some scholars claim that the interaction between multiple social, family and financial factors is complex and indicates the importance of using theories that help explain behavioural factors, such as the owner's need to be in control, that influence decision-making processes related to the financial structure. Scholars and professionals, when working with and researching such aspects of family business, should therefore consider the dynamic interaction between business characteristics, such as the size or industry, behavioural aspects of corporate finance such as business objectives and financial factors[69].

[69] Gallucci C. – Santulli R., *Family and non family firm's financial structure. The effects of financial crisis*, Giappichelli Editore, Torino, 2017

Chapter 3

The Private equity and family businesses: the evolution over time

Overview: 3.1 The role of *private equity* in the *family business* management process. 3.2 The main market data: growth over time. 3.3 *Private equity* as a tool for the development of small and medium *family business*es.

In the Italian context, *private equity* funds represent a solution to bring more capital to businesses, to counter the imbalance towards the banking system and to ensure continuity and growth for *family businesses*. Although the entry into the company can be considered "invasive" by members of the family, the objectives of *private equity* are in some ways common to those of the entrepreneurial family as both want to give continuity to the company by demobilizing their investment at a higher value. Finally, *private equity* brings many advantages to *family businesses*, such as a well-defined strategic vision, careful management of the company's financial capital and a very broad network.

3.1 The role of *private equity* in the *family business* management process

Private equity funds are becoming increasingly important on the national and international economic scene for their role of intervention in support of companies of all sizes in order to develop their business.

Today, *private equity* is an important opportunity for *family businesses* that, through these funds, can find the desired liquidity; liquidity that they can dispose of in the medium term without necessarily having to remunerate the capital in the short term. An entrepreneurial family, in fact, may find itself with limited resources, so it must constantly find the necessary capital to support and drive its growth.

When we talk about *family business*es, we are referring to a group of businesses with substantially different characteristics, especially in terms of structure, size and governance models. A common feature is the family's control over the management: the partners who control these companies - the members of the family - have an incentive to monitor management activities more closely because they are strongly linked emotionally to the company.

This last aspect is certainly a great advantage because the entrepreneurial family - particularly in times of crisis - will try to ensure business continuity[70].

In turn, family capitalism entails certain disadvantages that affect both the economic and financial system of the country.

F*amily business*es show a low propensity to be listed, not because of the small size but because of the will of the majority shareholder not to lose control over the company. *Family businesses* prefer to finance themselves mainly with debt capital from banking institutions.

However, as a result of the financial crisis that has occurred in recent years, banks have been forced to reduce the assets held in their portfolios at the expense of companies, especially those of smaller size, because of the lesser information they are able to provide and the lower risks that banks themselves may take on as a result of Basel 2 and Basel 3[71].

In response to these regulations, legal systems have been looking for new financial instruments that could direct funding towards equity in order to overcome the problems of undercapitalisation of companies.

Fortunately, institutions that provide these services have been created, such as *private equity* funds, which allow investors to participate in the risk capital of companies. *Family businesses*, beyond their size, have also been damaged by other risks inherent in their ownership and management structure. These two considerations have led to the creation of a number of entities that can help them both financially and in terms of management: *Private Equity and Venture Capital*.

The Italian association of *Private Equity and Venture Capital* defines these activities as "institutional investment activities in the risk capital of unlisted companies, with the aim of enhancing the value of the company invested in with a view to its disposal within a medium to long-term period". The *Private Equity* Fund aims to become a full-fledged member by providing financing and managerial skills to the company/family in order to make it grow and, consequently, sell it.

Private equity activities are diversified according to the life cycle of the company and the dynamics - internal or external - it has to face.

[70] Corbetta G. – Dematté C., *I processi di transizione delle imprese familiari, op. cit*., p.56

[71] Fidanza B., "*Private equity in Italia: caratteristiche del mercato e ruolo per le imprese*"

The Venture capital is a segment of *private equity* that specialises in financing companies in the early stages of their life cycle:

1) seed financing: intervention of the investor in risk capital when the entrepreneur has an idea but there is no product;
2) start-up financing: the investor intervenes in the production start-up phase. It should be noted that at this stage the experimentation phase has been passed and there is already an embryonic organization that has started the first market research. The investor provides risk capital with adequate financing to support the development of the company's organization, production phase and marketing. The investor continuously monitors the activity of the company through the participation in the board of directors with representatives who participate in the definition of the business strategy.

In addition to the venture capital business, *private equity* funds can undertake two additional activities:

- the *Development Capital*: the first activity is aimed at supporting the company's internal growth plans such as, for example, the launch of new products or penetration of new markets and external activities such as the acquisition of a company or the issue of a convertible bond. The second activity is very important, especially for *family businesses*. Development Capital aims to replace minority shareholders;
- the *Buy-Out*: on the contrary, it consists in the activity of replacing the majority shareholders, therefore the PE can be a means in the succession phase and when, given the will of the heirs, the entrepreneur decides to sell the company. Therefore, this activity is very important especially for the *family businesses* that are the subject of our analysis.

The starting point for the intervention of *Private Equity* in the history of *family business* is the choice of the future financing partner who must make the necessary analysis of the target company to be acquired.

First of all, it is important to use some "macro" observations to estimate the risks and potential of the sector and thus proceed with the study of the attractiveness of the sector, assessing how its degree of competitiveness and maturity influences the performance of companies.

Consequently, another fundamental aspect is the degree of growth and expansion of the sector, synonymous with the possibility of growth in sales of the target company. Companies operating in capital-intensive sectors are riskier because of the need to invest a very large amount of capital in production capacity and material assets. As a result, these companies have high fixed costs that affect profitability both negatively - if the break-even point is not reached, substantial losses would be incurred - and positively because, on the contrary, if the break-even point is exceeded, very high profit margins will result. In addition, capital-intensive sectors need long-term financing by further increasing the risk profiles of the companies operating in them.

After studying the sector - an analysis that allows to understand what the prospects of the company are – a "micro" study is needed to understand the competitive position and performance of the target company.

The next step is an accurate survey of the liquidity, solvency and historical performance of the target company[72].

The studies undertaken by the *private equity* firm before investing in a *family business* are detailed and very long but are fully justified by the management of the company to increase its value. From the latter point of view, the strong collaboration that must exist between the investor and the entrepreneur at the head of the family is of fundamental importance.

The collaboration between the entrepreneurial partner and the *private equity* is crucial to allow the meeting between the operational capabilities of the former and the financial capabilities of the latter. Together, the two parties will be able to better define the financial and operational strategy of the company.

The entrepreneurial partner is the one who had the entrepreneurial idea, the one who shaped the company according to his beliefs by defining the internal culture. The investor partner cannot allow his direct exit otherwise he would risk annihilating the productivity of the company, so it can be said that the first investment is made in the entrepreneur partner to ensure that he has an active role throughout the life of the investment. (or at least, if the entrepreneur decides to alienate his

[72] To undertake this analysis and compare the different target companies, the private equity fund uses EBITDA (also called Gross Operating Margin). This is calculated as Production Value - External costs - Personnel costs. EBITDA is a good indicator because it does not include depreciation, amortisation and write-downs, items in which there is a risk of so-called "business manoeuvres" on the part of management. It is also easy to calculate and provides a good approximation of profitability.

participation, until the PE has managed to create the right culture to maintain a good level of productivity).

In this context, rules of corporate governance are created to guarantee the stability of ownership and the involvement of the entrepreneurial partner:

- the *lock-up rule* by virtues of which the investor partner undertakes not to dispose of his shareholding for a limited period of time;
- the *earn-out rule*, which consists of pre-established deferred payments (and linked to the achievement of certain objectives) of the purchase and sale price of the shareholding to the entrepreneur who has sold his share. This tool is used to ensure that, even after the sale, the entrepreneur continues to maintain an operational role in the company;
- the *exit ratchet agreement*, under which, at the time of the divestment by the PE, the entrepreneurial partner undertakes to acquire the shareholding of the outgoing partner in such a way as to increase its shareholding. The entrepreneur must remain central to the life of the company and the systems put in place by the PEs are all designed to keep him in the company with important roles until the end of the investment[73].

The generational turnover is a complex process, which certainly does not end in a simple act but brings with it on the one hand threats and on the other opportunity for the future of the company, depending on the choice that will be made.

The sudden lack of the entrepreneur, the inadequate preparation of the family members, the unavailability or impossibility of these to assume responsibility, irremediable conflicts between the heirs, represent some of the main threats.

At the same time, the process of replacement can be an opportunity because it can represent for the entrepreneur an occasion to rethink and reformulate the strategy: in addition, also young and enthusiastic forces can give new energy to the company. The moment of the delivery passage is therefore critical, particular importance must be placed in the choice of the successor. It should be borne in mind that not always its heirs are the best choice for business improvement. In fact, the main characteristics of an entrepreneur are many, such as creativity, ambition to succeed and propensity to risk. Heirs are not always in the right position to sacrifice their

[73] Giacomelli S. e Trento S., *Proprietà, controllo e trasferimenti nelle imprese italiane. Cosa `e cambiato nel decennio 1993-2003?*, in “Temi di discussione, Banca d’Italia”, 2005.

management role, and too often this step is taken for granted, without paying too much attention to what is actually the best choice for the company.

Of course, you don't become an entrepreneur simply because someone gives up the reins of command. This means that parents must carefully examine existing and future problems and the related risks involved must be approached from the outset to be able to limit them effectively.

This is a critical moment for the life of the company because often successors may not have the same entrepreneurial and managerial skills as their predecessors, they may not have the same interests in the management of the company or they may have to deal with a greater number of partners, the heirs.

It is therefore necessary to analyze how the generational change can take place without risking negative repercussions knowing that the heirs are faced with the choice to continue autonomously the management of the company or entrust it to an external administration independent of the family[74].

For this reason, therefore, the crucial importance of corporate governance is reaffirmed, which implies the division between ownership and management, in order to protect the interests of the various categories of stakeholders, through a transparent corporate management, a functional control system and an easily accessible information flow.

An element therefore to be taken into account in *private equity* transactions is the importance of family meetings and of the board of directors, fundamental moments of meeting to define the strategy of the company, establish guidelines in case of difficulties, pass on ethics and values to management and manage generational changes.

The *family business* is considered as an entity that changes over time, both in its form and in its structure. In *family businesses*, especially small and medium sized ones, meetings and assemblies are often held informally and with low frequency, often limited to comparisons between managing partners. On the contrary, even in the smallest *family businesses*, a formalization of the meetings, increasing their frequency and extending them to middle management, would be a fundamental aspect both for the daily management of the company, which would be strengthened, and from the point of view of attractiveness in the control market.

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[74] Montemerlo, D., *Il governo delle imprese familiari. Modelli e strumenti per gestire i rapporti tra proprietà e impresa, op. cit.* p. 47

Furthermore, these scheduled family reunions would help increase the solidity of the family and the business, especially in the face of the most critical situations.
They also allow to create moments of confrontation and discussion on what will be the generational transition, thus allowing a more careful planning, and to pass on the values and traditions that have characterized the company in its way of acting to the youngest.
They also serve as a tool for managing the relationship between the family and the board of directors, a relationship often hampered by conflicts caused by the centralizing behaviour of family members, which in this way reduce the role of the board member. The role of family assemblies in solving all the above problems and in identifying key profiles and competences for the future of the company is therefore highlighted. With the introduction of *private equity*, the board of directors assumes a fundamental role as an organ of the company and not of the family. The role of the board of directors of a *family business* consists in defining the business strategy, monitoring the work of the management and choosing key figures such as managing directors and managers. Three orders of functionality for the board of directors can then be identified:

1. strategic;
2. recruitment;
3. control.

The first order of functionality refers to the role played by the board of directors in defining the strategies to be adopted on the basis of the context in which it operates, the opportunities offered by the market and its potential, so as to obtain the best possible results for the company. The second refers instead to the key role that the board plays in "recruiting" the resources, profiles and skills that are lacking in the company. Finally, the control role consists in verifying the consistency of the work of the management in relation to the strategic guidelines defined by the board. Defining whether a board of directors of a *family business* is a truly useful and effective body for the purposes of the business's activity, or whether it is set up purely as a formality is not easy. For years there has been and continues to be debates on the composition of the board and on the cruciality of members outside the family. This is certainly a subject of fundamental importance, for the whole series of reasons discussed above. Equally important are the skills, both strictly technical-professional and transversal trasversali[75], of the directors, namely the ability to create a dynamic and proactive body both in relations with the property and with the management, and within itself. This is probably the factor that determines the effective and efficient functioning of the board of directors.

The succession procedure, although supported by careful planning, requires careful assessment and therefore provides for not short timeframes. However, this can represent, in a broader sense, an opportunity to improve its structure and organization, key factors to achieve good performance in a competitive environment. It is therefore possible to identify some key moments of this procedure, which are consistent:

- in the analysis of the organizational structure, trying to identify possible shortcomings and possible efficiencies;
- in the analysis of managerial roles, identifying an optimal situation of skills and responsibilities to be compared with the actual situation;
- in comparison to the ideal and the real governance situation, from which an organizational structure is designed in which roles and responsibilities are well defined, in view of the current and future needs of the business;
- in the identification of successors and in the possible replacement of managers and executives;
- in the determination of a well-defined recruitment system for family members;
- in the definition of training programmes for new recruits, so that they can develop the skills necessary for the role they are going to play;
- in the development of a remuneration system based on the principle of meritocracy, so that managers are rewarded on the basis of their contribution in terms of performance, and not for their ties with the family that owns them.

A succession procedure of this kind allows companies to structure themselves, thus becoming less "family" and more "enterprise". However, the complexity of this process must be acknowledged, which sometimes requires the advice of professional figures. The advantages brought by *private equity* are numerous and also include the improvement of the managerial culture within the company: the

[75] Sciarelli, S., *La gestione strategica dell'impresa*, Cedam, Milano, 2016

financing company provides the ability to outline development strategies and help the development of a network necessary to increase growth opportunities through mergers or joint ventures[76].

The entrepreneurial partner is the holder of the specific operational know-how of the company. Together, the two subjects are able to create the right conditions to meet the most advanced competitive contexts.

The inclusion of numerous rules for the *corporate governance* of the company therefore entails a more structured organization. This aspect is not only fundamental for productivity, but also sends a positive signal to the market and banks through high transparency and a better-quality flow of information which results into lower rating and lower financing costs[77].

All this appears to be very beneficial for *family businesses.* The reason for this is the company's transparency vis-à-vis third parties.

Private equity is a strategic partner for *family businesses* in the management of generational turnover.

"The best solution would be to carry out the change of leadership from the old to the new generation together, taking the opportunity to bring capital, skills and networks to the company. In short, it is more effective to manage the transition while creating a strong discontinuity in capital because such an operation strengthens the company, introduces rules less dependent on family dynamics and offers new incentives to the young entrepreneur who succeeds[78]."

In the event that the company continues its life within the family, *private equity* is able to liquidate the partner (the heir) not interested in the company by taking over the shares without forcing shareholders to affect their assets and avoiding possible family conflicts.

In the event that the company does not continue its life within the family, *private equity* is able to give continuity to the economic activity by buying by making a buy-out on the entrepreneurial partner[79].

Finally, funds can be a pole of attraction for a better human capital with the necessary skills to bring the company from a family management to a managerial management. In conclusion, the benefits of *private equity* investments are very

[76] Ibidem

[77] AIFI, *Private Equity e Corporate Governance delle Imprese*, op. cit., p. 15

[78] Available on https://www.corriere.it/economia/family-business/notizie/passare-timone-funziona-meglio-se-si-apre-l-azienda-mercato-2580fca4-49e8-11e9-bd93-d4c05434d013.shtml

[79] Costa G., Nacamulli C.D., *Manuale di organizzazione aziendale vol. 3*, p. 201.

important and, in the critical phase of generational turnover, represent an opportunity for growth, development and improvement of the company's capital.

3.2 The market: growth over time

The family ownership structure that characterises most of the companies in our country involves two types of problem, one of a generational nature: in the sense that those who inherit the company often do not have the same innovative drive as the entrepreneur who founded it; the second concerns the traditionalist character of the owners of small and medium-sized Italian companies, who often tend to be very rooted in their origins and traditions, showing more distrust in accepting the support of companies such as those that operate in *private equity*.

Despite the critical points identified, the Italian market could be a fertile ground for the development of a financial culture of *private equity* and, despite the difficulties of access and the fragmented nature of the market that has high costs to manage, in recent years our country, thanks to its excellence, has attracted the attention of some foreign operators, who have played a significant role in *private equity* transactions within the real Italian economy.

In the decade between 2010 and 2016, 101 international operators were in fact operating in our country, making 182 investments: a demonstration of a growing trend that saw the 15 transactions carried out in 2010 become 41 in 2016, recording an overall growth in operators of 20%[80].

The geographical origin of the investors who looked to Italy in the period 2010-2016 is as follows:

- 32% is based in the United States;
- 28% is based in Germany;
- 18% is headquartered in France;

In recent years, Chinese operators have also been looking with great interest at our country, so much so that several of them, active in the *private equity* market, have already completed operations in Italy, such as, for example, the recent acquisition

[80] N. Emanuele - A. Gervasoni "*Gli investimenti dei fondi di private equity internazionali e il ruolo dell'Italia*", AIFI, 2017

in 2017 of 30% by the Chinese company Hony Capital, of the brand Mr & Mrs Italy owned by the company Duemmei sold by the Holding company Magnolia[81].

What most attracts the Chinese and foreign operators in general is the Made in Italy "brand". The arrival of Honey Capital will serve to leverage such factor and position itself in the Asian market, this is a clear example of how *private equity* acts in terms of innovation of corporate structures accompanying them in the process of growth and development when they are ready to expose themselves and open to international markets. To demonstrate the importance of the experience and knowledge of Italian companies in terms of production, the industrial goods and services sector was the one that in 2010 - 2016 received the highest number of investments from foreign investors: we speak specifically of 39 deals.

This is followed by the fashion manufacturing sector with 30 operations, 19 operations for ICT, 17 for medical: these two sectors have developed the most in the last period, in fact in 2016 they represented the main sectors, with 9 and 7 operations respectively.

Finally, 16 operations involved the consumer goods and services sector in the period 2010 - 2016, while other market sectors: financial and insurance, energy and manufacturing environment - environmental and retail, attracted a smaller number of operations during the decade analysed by AIFI (2017).

In addition, a recent study by PwC, in 2017, estimated that *private equity* had a direct impact on the performance of the companies it owns, resulting in net growth differences compared to companies not owned by *private equity*: from 2005 to 2015 the growth in revenues of these companies is significantly higher than the growth rate of Italian GDP (+4%).

The employment growth rate is also higher than the employment growth rate of Italian companies (companies in which PE has a stake has a 4.9% rate of employment growth compared to the 0.5% rate of Italian businesses without PE). Moreover, between 2005 and 2015 it is evident that *private equity* contributed to the increase in jobs, as many as 12,000 between 2012 and 2015 alone, despite its still limited development in Italy.

[81] Invest Europe, *Central and Eastern Europe Private Equity Statistics* 2016.

Companies subject to buy-outs always recorded higher revenues (2.8%) and an EBITDA margin of more than 7.7% in the period 2005-2015[82].

Capital investments prove to be a driving force for the innovative development of companies. One of the main objectives of *private equity* is to contribute to the development of the company by providing know-how and managerial resources with international and innovative experience.

It is 2018 that confirms the strategic role of *private equity* in Italy: 359 transactions recorded on the Italian market, distributed over 266 companies, for a value of 9,788 million euros, the highest value ever recorded in the Italian market, thanks to numerous transactions of significant size, carried out mainly by international players[83].

Compared to the previous year (4,938 million euro invested in 311 transactions), the amount invested almost doubled (+98%), while in terms of number of investments the growth was 15% (Chart 1).

Evolution of the investment activity

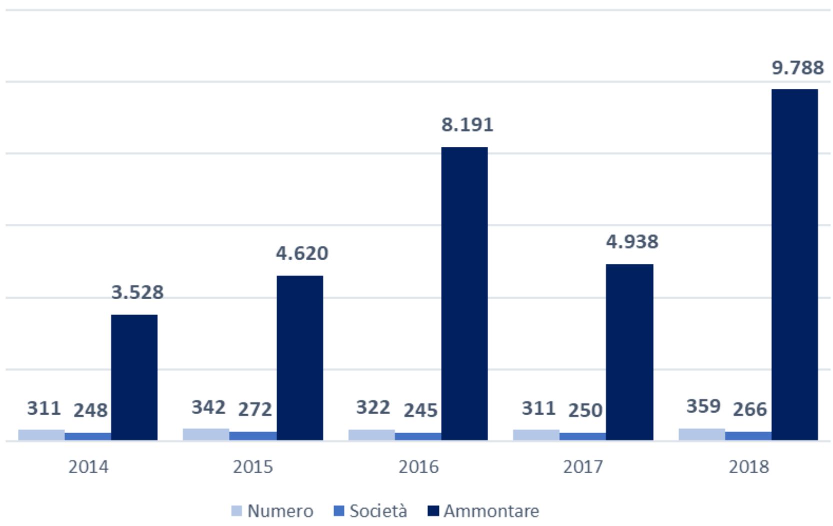

Chart 1

With reference to the type of transactions carried out (Chart 2), in 2018 buy-outs continued to represent the market segment to which most of the resources were transferred (€5,242 million), followed by investments in infrastructure (€3,041 million) and the expansion segment (€816 million).

[82] Ibidem

[83] AIFI, *2018 Il mercato italiano del private equity, venture capital e private debt,* Milano, 2018

Distribution of investments 2018 by type

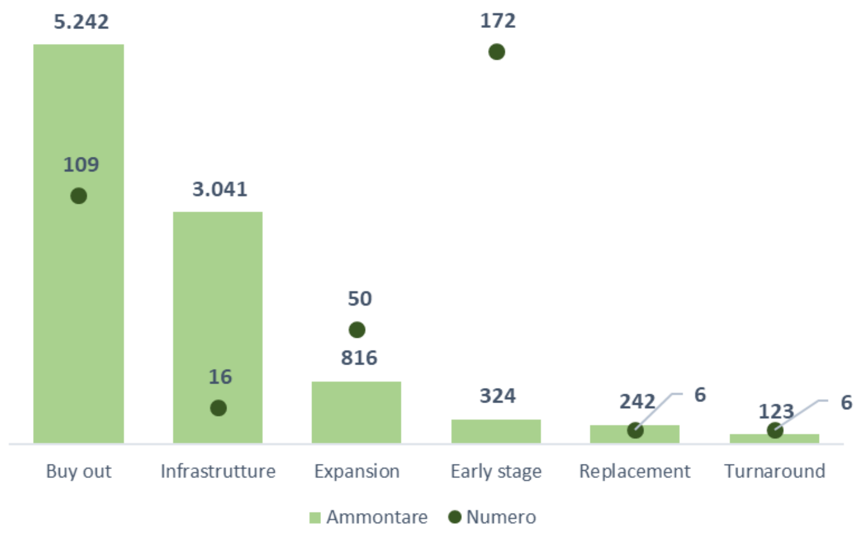

Chart 2

In terms of number, with 172 investments made, the early stage was once again in first place, followed by the buy-out (109 transactions), while expansion operations were 50. As regards the activities carried out by the various categories of subjects (Chart 3), international operators absorbed 66% of the market in terms of amount invested during 2018, equal to 6,438 million Euros, followed by domestic operators of regional, public and institutional origin (2,111 million, equal to 21%).

Distribution of investments 2018 by type of operator

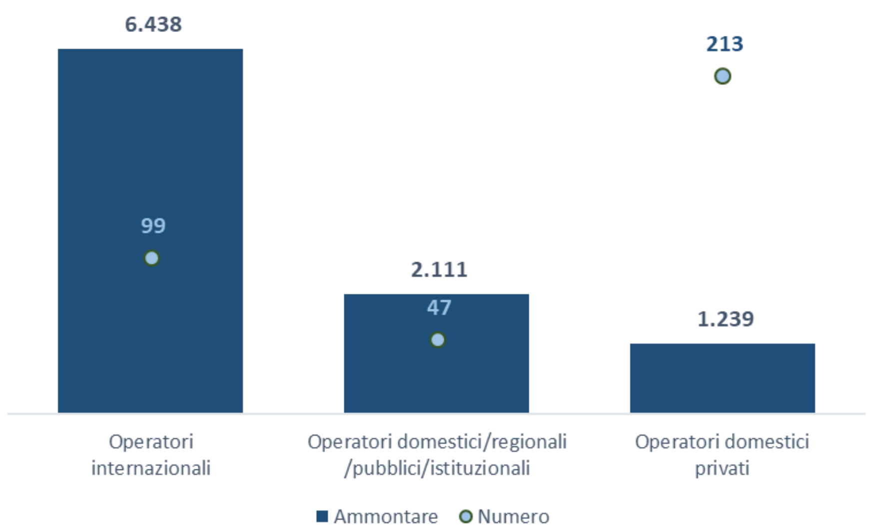

Chart 3

It should be noted that international operators without an office in Italy have invested 2,675 million Euros in the country, distributed over 49 operations. In terms of number, private domestic operators made the largest number of investments (213, or 59% of the market), followed by international operators (99, or 28%).
In general, in 2018 the average cut in the amount invested per transaction was 27.3 million Euros, up compared to 2017 (15.9 million Euros). The normalized figure, namely the net of the large and mega-disposals made during the year, on the other hand, was €11.2 million, in line with 2017 (€11.0 million) (Chart 4).

Average amount invested by type of transaction in 2018

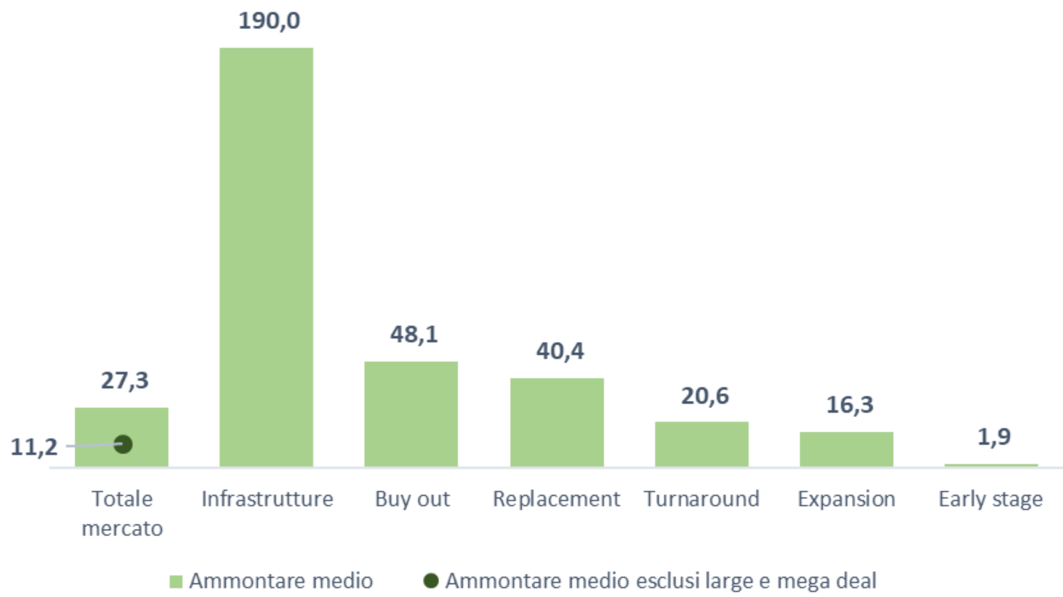

Chart 4

Considering the companies involved in the investment, in 2018 there were 5 transactions with paid-in equity between €150 and €300 million (large deal) and 8 transactions with an amount greater than €300 million (mega deal). Overall, large and mega-disposals attracted resources of €5,925 million, equal to 61% of the amount invested in the year (€1,598 million, equal to 32%, in 2017, characterized by only 8 large deals and no mega-disposals). Transactions with paid-in equity of less than €150 million (small and medium deals) amounted to €3,863 million, up 16% on 2017. The amount invested in small and medium deals is the highest ever invested in the Italian market (Chart 5).

Evolution of the amount invested by size of the operation

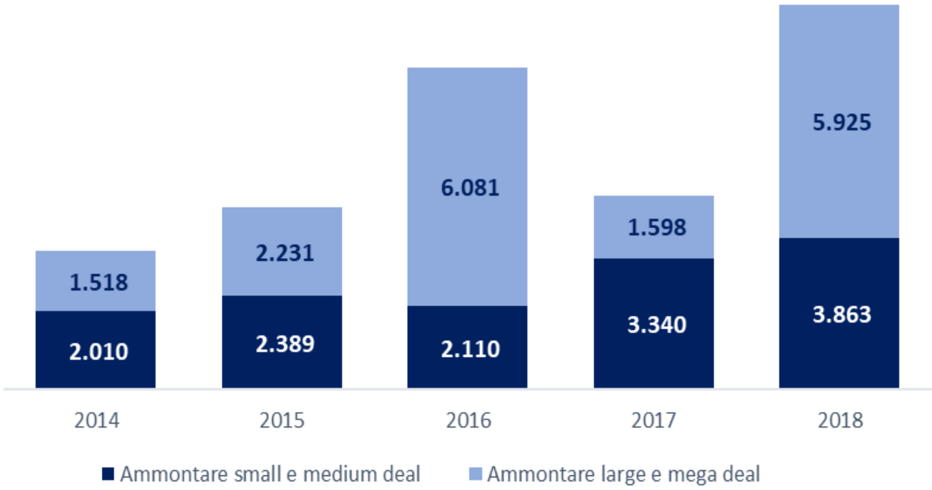

Chart 5

In 2018, therefore, the amount invested in the Italian *private equity* and *venture capital* market reached its highest value ever, thanks to a number of significant transactions that took place not only in the buy-out segment, but also in the infrastructure segment, which in recent years is playing an increasingly important role. Funding activity on the private market grew in 2018 and saw the closing of more than 25 operators: it should be underlined that pension funds and social security funds represented the first source in amount.

Private equity, as a financing system used by *family businesses*, not only supports these companies through the contribution of capital, but its action has a direct impact on the real economy of the countries in which it operates, contributing to the generation of new jobs and the growth of revenues of the companies acquired, in terms of productivity, investments and EBITDA.

The presence of the *private equity* tool helps to structure the decision-making mechanisms of top management according to more advanced logic, favours the development of clear rules of governance and helps to resolve some critical issues such as the role of the second and third generations in the company.

Still today, *family businesses* are a structural element of primary importance in the development and consolidation of world economies, so much so that they represent the oldest and most widespread form of enterprise.
Family businesses (Italian family business) must be studied in depth and known above all in their fundamental characteristics as they have, among other things, a decisive weight in the national economy[84]. These are companies which, at times, have more than a century of life, others show a few months of operation and numerous companies have not had the possibility of going beyond the entrepreneurial idea of the founder and have immediately disappeared.
Family businesses that have survived require management that is only apparently and superficially similar to other non-family businesses[85]; in truth, running a *family business* is always a difficult task and the related family assets do not escape this difficulty of management, which requires very special procedures.
Nevertheless, *family businesses* are still recognized as contributing to the progress of Western capitalism thanks to the family's ability to provide a strong and determined entrepreneurial spirit.
In short, *private equity* helps companies to grow and develop both by providing risk capital and above all by providing managerial and organisational skills.
Moreover, they are a support tool for maintaining a risk profile, often helping to lower it or manage it, preparing the company for that continuous, essential, vital dialogue with the market and, in many cases, for listing on the stock exchange.
For its part, *Borsa Italiana* requires, for companies in the New Market that have been operating for less than three years, the presence in the capital of an institutional investor for at least 10% of the share capital[86].
All this helps a new business culture that is more attentive to development but also more prudent and sensitive to the needs of stakeholders. But the *private equity* industry is also evolving and must accept the challenge: make the leap in size to become truly competitive with respect to Anglo-Saxon models, direct investments by giving more weight to the so-called "early stage" loans, while leaving intact the ability to create value over time through a conscious exit strategy, and promote

[84] Available on https://st.ilsole24ore.com/art/SoleOnLine4/Finanza%20e%20Mercati/2007/03/pmi-private-equity.shtml
[85] Ibidem
[86] AIFI, *Private Equity e Corporate Governance delle Imprese*, op. cit., p. 18

greater diversification of sources of funding by reducing dependence on the banking channel[87].

Today, the conditions of the context seem mature and the road must be travelled urgently. The country can and must rely on an indispensable tool for the development of the system and for the strengthening of its industrial structure and, in particular, of those companies that, in terms of size, vocation and growth ambitions, represent natural candidates for listing on the stock exchange.

3.3 *Private equity* as a tool for the development of small and medium family businesses

The structural and functional characteristics of *family business*es can be identified in four areas:

- *enterprise-family relations:* it is the conceptual and methodological container of all the problems that insist on one of the most exclusive characteristics of the *family business*, that is, the complete mixture of work and private life. The literature has identified a series of problems: from the composition of the board of directors to the committee of family members, up to the absence of a family council; from corporate governance to family pacts; from paternalism in the absence of operational delegations to the transfer of family culture and values; from corporate nepotism to the integration of family members; from conflicts following family favouritism to the presence of family members interested only in a position of economic income; from the choice of heirs to the remuneration of family members; from the management of succession and business continuity to the difficulty for children to take over the place of their father who modelled the company on their own existential and strategic vision[88].
- *business model:* it collects all the specific characteristics of the business model adopted by the *family business*es both in its different and consequential phases and in its strategic-organizational particularities. Reference is made to what the literature also points out in terms of: elements of obsolescence

[87] PWC "*L'impatto economico del Private Equity e del Venture Capital in Italia*", 2017

[88] Anderson, R. C., & Reeb, D. M., "*Founding-family ownership and firm performance: Evidence from the S&P 500"*. The Journal of Finance, 2013, 58(3), 1301–1327.

related to the original business formula, difficulty in renewing the business formula, difficulty in finding financial resources expressed by debt capital and risk capital, characteristics that must possess employees when they are placed in the company, belonging to an industrial district that requires precise rules of the game and difficult to negotiate in the short term. Moreover, the business model often turns out to be built on a confused organizational formula without a customer service, with denied access to foreign markets and limited in feeding growth processes through effective and original financial leverages, making it difficult to attract key people to the lasting success of the company.

- *risk level* identifies specific events that can seriously compromise - often irreversibly - the success or existence of the *family business*. These events have not yet been addressed with sufficient determination and knowledge through appropriate programs of "*vulnerability analysis*". Examples that the literature highlights as elements of riskiness typical of the *family businesses* are, among others, the following: technological risk (potential inability to jump down from an obsolete technology and get on to an original technology); financial risk (represented by the well-known paradox "rich family-farm poor[89]", in which large cash flows are taken away from the enterprise to fuel large expenses or investments in favor of family members); operational risk (determined by the origin of the operating income of the characteristic management and caused by the anomalous cost structure and the fragile composition of revenues); risk linked to the founder's loss (when the entire corporate governance structure is strongly or totally dependent on the personal and professional characteristics of the historical head of the company); country risk (when exports are concentrated enormously in countries with a low or very modest degree of political stability); risk of the "prudent farmer" (typical of those farms in which the second generation heir and main owner blocks growth and takes away the wings of strategic organizational innovation or of his professional updating and of the few key people who revolve around him for fear of losing control or for lack of vocation/entrepreneurial ability); inability of the heirs to continue the work of constant growth that made the fortune of the first generation; inability of

[89] Corbetta, G., "*Le aziende familiari – Strategie per il lungo periodo*". Egea Edizioni, Milano, 2010

the entrepreneur to manage the transfer of the corporate culture; the continuity of succession: arriving at the moment of passing unprepared to give up or lead the *family business* at the right time and manner; loss of key people or implicit acceptance not to spread their know how and sector risk (when the specific demand of the market in which it operates is generated by extraordinary events not to last).

- *economic and financial profiles*: the last macro area consolidates the problems connected with the governance and management of income, financial, equity and monetary masses generated and absorbed by the *family business*. Also in this case, there are many problems that the literature underlines as critical aspects of family business governance: generational drift, cooling of financial relationships between partners, mixing of family and business assets, reorganization of the corporate structure, closure at the entrance of risk capital outside the family, confusion and mixing of income flows between family and business and not least the evaluation of their *family business*.

The effects of the financial crisis on business families have represented for the activity of *private equity* in Italy, not only an element of partial slowdown, in particular with regard to larger operations, but also, at the same time, an opportunity for recovery, especially for SMEs, acting as a factor in stimulating new processes of value creation and as an alternative financing channel to the banking one[90].

The new opportunities deriving from the typically anti-cyclical configuration of the investment in risk capital are associated with a progressive change in the approach to the activity itself. In fact, the latter, as mentioned above, was in the past characterized by a modus operandi substantially aimed at the strictly financial profiles of the operations and then moved, in more recent times, in the direction of an industrial approach, aimed at supporting the evolutionary path of the companies[91].

Private equity investors therefore play a more active role in the financial and strategic management of companies in order to respond to the typical needs of SMEs in phases of internationalization, growth and generational transition.

The level of involvement of the private equity intermediary in the business activity is often sanctioned by specific contractual clauses. At the same time, the degree of

[90] De Vecchi C., *Il private equity come strumento di evoluzione della piccola e media impresa*, Convegno "Equity: finalità, organizzazione, strumenti", 7 novembre 2011.

[91] Ibidem

control that the investor can exercise over business decisions can be defined in advance.
This is achieved through contractual provisions defined in terms of voting rights, exit models, non-competition clauses on the part of the entrepreneur and conditioning of the disbursement of financing tranches subject to the achievement of set objectives, in particular for investments in the early stages of business development in relation to the greater degree of uncertainty that characterizes them.
In fact, the use of appropriate contractual and governance instruments represents an incentive for the entrepreneur, on the one hand, and a greater element of security for the financing subject, on the other. The latter is thus guaranteed through predefined mechanisms of power of control over the company.
Among the contractual provisions aimed at mitigating the effects of information asymmetries and at enhancing the incentives of the subjects involved, in addition to stage financing - namely the subdivision of the financing into different stages subject to the achievement of objective company results - the recourse to monitoring and governance mechanisms on the financed company is noted.
The private equity operator can resort to these mechanisms through, for example, the provision of rights to appoint members of the board of directors and powers of veto on the most important management and strategic choices of the company, such as, for example, decisions relating to capital increases or the degree of indebtedness. Again, with a view to protecting risk capital operations, non-competition clauses are also usually the subject of contractual negotiations, aimed at guaranteeing the exclusivity of the entrepreneur's commitment in the context of the financed activity. Finally, the aspect relating to the methods of exit from the investment for both parties involved is also particularly important[92].
The exit phase, namely the transfer of the shareholding, represents in fact a delicate moment of the operation and therefore presupposes an appropriate preliminary definition of its characteristics. This is made in order to limit the possibility of "exit" of the entrepreneur from the company, especially where the transfer to third parties of the controlling shareholding of the latter can have important repercussions on the value of the minority shareholding of the private equity operator[93].

[92] Tagiuri, R. & Davis, J. (1996). "*Bivalent attributes of the family firm*". Family Business Review, 9(2), 199–208
[93] Ibidem

At the same time, the contractual provisions agreed in the document are also aimed at offering the lender opportunities for divestment if the target company, after a certain period, does not prove to be in line with initial expectations of enhancement. The active role of risk capital investors is also connected to the stake held and is mainly reflected in the management and strategic support that they are able to offer, in parallel with the financing, facilitating the process of further raising of capital through the banking channel, or encouraging the initiation of growth and internationalization operations through agreements with other companies. On the other hand, the contribution of technical, industrial and production knowledge that the investor can usually offer is lower, due to the need for specific skills in the market sector in which each company operates.

The ultimate aim of the private equity investment is therefore to enable the target company to efficiently face the challenge deriving from the growing degree of competitiveness and innovation of the market, thus achieving the enhancement of the participation itself.

Italian SMEs are in fact at a competitive disadvantage compared to European competitors due to their lower self-financing capacity, which is associated with the negative economic effects, as well as lower levels of internationalization and innovation[94].

In this sense, the intervention of risk capital can represent a valid response to these structural deficiencies, as demonstrated by the recent public finance initiatives undertaken in favour of SMEs (in particular, think, among others, of the Italian Investment Fund), in the direction of a virtuous synergy between private operators and public investors in the establishment of private equity funds with public and private participation. In particular, the support of *private equity* is especially significant in some stages of corporate development that often reflect the configuration of Italian SMEs and otherwise limit the opportunities for growth or survival in the competitive dynamics[95].

In more specific terms, the economic and social impact of private equity activities is more influential for the development of SMEs when interventions are aimed at encouraging dimensional growth, managing the generational shift and supporting the process of internationalization.

[94] Bracchi G. e Gervasoni A., *Venti anni di private equity*, Egea, Milano, 2006
[95] De Vecchi C., *Il private equity come strumento di evoluzione della piccola e media impresa*, op. cit.

The Italian productive fabric is mainly made up of small companies whose ownership structure is family-based. This peculiar configuration explains the nature of most of the objectives of risk capital investments and the demographic nature of the enterprises to which they are directed[96].

More than half of the private equity operations in Italy are carried out in favour of companies with less than 200 employees and, in this context, the ability of the private equity intermediary to favour the growth of the target company, in order to increase its competitive capacity, takes on strategic importance.

The objective of dimensional development is often achieved through the aggregation of independent and complementary companies (this type of intervention is called cluster ventures) which, operating in similar market sectors for types of products and technologies, present considerable development opportunities through the creation of economies of scale and operational and strategic synergies.

The aggregation process, which may involve more than one investment company, allows for the optimization of the exploitation of technical, managerial and financial skills within the established industrial pole, while allowing the individual entities to maintain their own independence linked also to the original production focus. The final objective of the intervention is therefore represented not only by the growth in size, and therefore by the higher overall competitive level achieved by the target companies, but also by the improved financial attractiveness of the Group, in view of new forms of resource collection.

A further moment in which the intervention of private equity intermediaries can often have a decisive impact is represented by the phase of generational transition sometimes experienced by SMEs with management and financial difficulties. In this case, the entry of the institutional investor represents an instrument of support not only economic, but also consultative, offering the property the necessary support to outline new structures and related development projects of the company[97].

However, the generational transition phase in the management of *family business*es is often associated with delicate profiles of resistance on the part of the property to the intervention and role of new partners in the corporate structure. In fact, unlike resources obtained through bank financing, the entry of an institutional investor

[96] Ibidem

[97] PEM *Rapporti Private Equity Monitor*, 2007 - 2016 www.privateequitymonitor.it

necessarily entails potential reasons for the future contestability of corporate control[98].

Although the presence of the private equity investor in the ownership structure is temporary, it implies a move towards the mobility of the private equity investor in the subsequent phase of disinvestment.

Despite the fact that the controlling shareholder has the possibility to repurchase at a later date the stake held by the private equity intermediary, this is obviously not the only opportunity to exit the investment, which would otherwise be, in some ways, a credit operation.

Finally, the plan that sees private equity operators exploit their network of international relations in order to favour the potential of the target companies in the context of internationalisation processes is also of particular strategic importance. In this sense, the private equity investor plays a significant role for the company, not only because of the economic participation in the company, but also through the fundamental contribution that can be made in terms of contacts with other realities and aimed at facilitating the identification of foreign partners for international acquisitions or joint ventures, thus also benefiting from the opportunities arising from the single European market[99].

For this reason, the entry of the private equity intermediary into the development dynamics of Italian companies, especially small and medium-sized ones, is crucial.

This is due, on the one hand, to the economic support, but also, on the other, to the fundamental contribution of skills in strategic terms and the solution of important steps of business development.

In any case, the intervention of a financial partner represents for the owner of the business a formidable opportunity to start new industrial processes, to proceed with financial restructuring if necessary, to renew its organizational structure and adapt the system of corporate governance to the needs imposed by the financial markets[100].

[98] Ibidem

[99] Forestieri G., *Corporate & Investment banking*, Egea, Milano, 2009

[100] Costa G., Nacamulli C.D., *Manuale di organizzazione aziendale vol. 3*, p. 206

Chapter 4

The case of the Pasubio Tannery

Overall: 4.1 The tanning pole of Arzignano. 4.2 The Pretto family: 60 years of history of the Pasubio tannery. 4.3 The advantages deriving from the process of internationalization. 4.4 Internationalization as a future perspective. 4.5 CVC Capital Partners and the control of the Pasubio Group. 4.6. The strategy of diversification for the growth of family businesses.

In the fourth chapter, it is explained how the tanning sector of Arzignano is strongly internationalizing to compete with realities such as the Chinese market. To win the challenge with the emerging markets it is necessary to have not only a good level of entrepreneurship and a made in Italy brand but resources to be allocated so that the business families can internationalize. The Pasubio Tannery, which in 2017 accepted a private equity transaction with the British fund CVC, is being examined.

4.1 The tanning pole of Arzignano

The tanning district of Arzignano, located in the Chiampo Valley in the province of Vicenza, represents the most important national centre and one of the main European centres in the tanning sector[101]. The leather processing industry in Vicenza has very deep historical roots: there are already reports of leather processing in some documents dating back to the fourteenth century. A catalogue of industrial products from Vicenza, dated 1855, speaks of the importance of leather tanneries for the economy of Vicenza. The hides came from Milan, Vienna or France and were worked and tanned in Vicenza. A decisive element for the development of these activities was the great availability of water in these areas, which was essential for the production processes, as well as for the discharge of wastewater. Another relevant factor for the development of the district is the presence of the Vicenza electromechanical sector, which at the time was already

[101] The district boundaries used in this paragraph are the same as most of the investigations carried out so far on the district of Arzignano, these are the municipalities of Altissimo, Arzignano, Brendola, Chiampo, Crespadoro, Gambellara, Montebello Vicentino, Montecchio Maggiore, Montorso Vicentino, Nogarole Vicentino, San Pietro Mussolino, Zermeghedo.

developed at national and international level. The real boom of the district occurred during the economic recovery that followed the Second World War, when the process of proliferation of local businesses began: many employees, after a period of training in historic tanneries, began their own business, using the technical knowledge acquired. In this period many of the companies that would later form the most important tanning groups of the district are born.

In the sixties, with the abandonment of tanning activities in other European countries, caused by anti-pollution regulations and the increase in labour costs, Italy found itself to be the ideal place for this type of activity, with low-cost labour and almost non-existent environmental rules. If at the beginning the technologies were imported by the German tanning technicians who came to work in the district, in 1962 the Technical Tanning Institute "Galileo Galilei" was founded in Arzignano, an important forge for the development of tanning techniques. The seventies constituted the period of maximum growth, in which the number of employees doubled and even more than doubled that of companies, while the previous district borders also expanded. Furthermore, the practice of home work and double work spread, mechanisms capable of ensuring high levels of production flexibility and adaptation to the trend of demand. The 1980s were essentially a period of restructuring, with a decrease in the number of companies despite an increase in employment, following closures and mergers of several companies. This is the consequence[102]:

a) increased competition from the countries supplying raw hides, favoured by low labour costs, low environmental constraints and the possibility of using technologies coming from the district and exported from the mechanical sector and by some experience of productive relocation of district companies;
b) increasingly fragmented market demand;
c) ever-shorter evasion times.

By local production system we mean a connected set of production activities carried out on the basis of organizational rules and skills rooted in the place[103]. A district[104]

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[102] Amatori F., Colli A., *Impresa e industria in Italia dall'Unità ad oggi*, Venezia, Marsilio, 2014.
[103] Ibidem
[104] Becattini G., *Distretti industriali e made in Italy: le basi socioculturali del nostro sviluppo economico*, Torino, Bollati Boringhieri, 1998

is "a socio-territorial entity characterized by the active co-presence, in a limited territorial area, naturalistically and historically determined, of a community of people and a population of industrial enterprises" characterized by belonging to a particular system of main local production. The industrial districts are therefore socio-territorial entities in which a community of people and a population of industrial enterprises integrate with each other. The enterprises of the district belong mainly to the same industrial sector, which constitutes, therefore, its principal industry.

Each company specializes in products, product parts or stages of the production process typical of the district. The enterprises of the district are therefore characterized by being numerous and modest in size and their relationships are based on cooperation between subjects who operate at different levels of the production system and competition between those who carry out the same activity. On the one hand, all this favours coordination and, on the other, gives the system a high degree of dynamism. The organization of the productive process within the industrial districts registers an elevated breakdown among different enterprises, each of which can achieve the advantages of the specialization such as efficiencies and economies of scale[105]. At the same time, the dense network of inter-firm relations ensures that the process has the elasticity in terms of volumes and the flexibility in terms of product differentiation needed to rapidly adapt supply to changes in demand.

In order to identify a district, two elements need to be examined:

1) local production system
2) manufacturing specialization.

First of all, the territory is regionalized on the basis of daily commuting, thus building local work systems. These are territorial units made up of several contiguous municipalities that are geographically and statistically comparable[106].

Secondly, the districts differ on the basis of an algorithm that provides:

- the local systems that have an industrial specialization superior to the national average;

[105] Florida A., Parri L., Quaglia F., *Regolazione sociale ed economie locali: attori, strategie, risorse. Il caso dei distretti conciari,* Franco Angeli, Milano,1994

[106] Sforzi F., *I sistemi locali di impresa e il cambiamento industriale in Italia*, F. Angeli, Roma,1995

- the share of the employed in the enterprises with less than 250 employees is greater than the national average share;
- at least in one sector the specialization is greater than the national one;
- at least one of the sectors thus identified is a small business, namely that has a share of employees in companies with less than 120 employees higher than the national quota[107].

In other words, a precise procedure is used starting from the local systems of work, to move to the industrial systems of small enterprises and then to the systems of small enterprises with the strong prevalence of a specific activity.

The local systems of small businesses are located in an area that goes from eastern Lombardy to Veneto, Emilia, the regions of central Italy to Abruzzo and Puglia along the Adriatic ridge. Small and medium-sized enterprise systems are mainly located in north-eastern Italy and central Italy. Large enterprise systems are located in north-western Italy (Piedmont) and southern Italy (excluding Campania and Sardinia).

However, it is not possible to draw up a definitive map of the district territory because very often in a limited territory with the same cultural background (i.e. in a district) several strong specializations coexist.

This is precisely the case of the specialisation of the tanning industry in Arzignano, which coexists with the specialisations in marble extraction and the construction of machine tools. The Italian tanning industry is a world leader in the sector, accounting for about 20% of world production and 70% of European production[108]. The second largest producer in Europe after Italy is Spain, with a share of around 14%. The production is geographically concentrated in production districts that represent about 90% of the national turnover.

According to Unic[109] estimates, Arzignano covers more than half of the sector's turnover, while the other most important areas of specialisation are: *Santa Croce sull'Arno* and *Ponte a Egola* (Pisa), with about 24%, and *Solofra* (Avellino) with 6%.

The main sectors of destination of the hides and skins are[110]:

107 Ibidem

108 Foresti G., Trenti S, *Il Distretto della Concia di Arzignano*, Servizio Studi e Ricerche, Banca Intesa, 2006

109 Ibidem

110 Becattini G., *Mercato e forze locali: il distretto industriale*, Il Mulino, Bologna, 2002.

- footwear (46,7%);
- furniture (24,6%);
- leather goods (12,8%);
- automotive (4,7%);
- clothing and gloves (6,7%);
- others (4,5%).

The entire Chiampo valley (the name of the watercourse that crosses the territory), with its 130 square kilometres, from Crespadoro to Montebello, from Montorso to Zermeghedo, is involved in tanning. The district specialises in the preparation and tanning of hides, mainly bovine and, to a lesser extent, calfskin. The destinations for tanned hides are mainly for the furniture sector and, secondly, for the footwear, automotive (interiors), leather goods and clothing sectors.

In the pole of Arzignano there are not only tanning industries proper, but also a whole series of companies specialized in collateral activities, the so-called "induced", from the mechanics of the machinery for processing to the chemistry for specific products, from contractors to traders.

On the foreign markets, where Italian tanners achieve 65% of their turnover, competitive pressures are increasing, in the face of a redefinition of the division of labour between the different countries and a reorganization of the production chains. Tanning is a highly integrated sector on an international scale, with the production of raw hides concentrated in breeding areas (Latin America, the United States and Oceania for sheep) and the use, on the other hand, increasingly shifted to the Asian area where there is a growing share of world manufacturing production and, in particular, of the sectors that use hides (footwear, leather goods, furniture[111]).

The main international competitors are increasingly located in emerging countries, both in Asia (Korea, China, Taiwan, India, Pakistan) and South America (Argentina and Brazil). These countries appear to have an advantage because:

- they control the raw material, moving more and more towards downstream processing and limiting the export of raw hides;

[111] Fontana.G.L., *Mercanti pionieri e Capitani d'industria-imprenditori e imprese nel vicentino '700 e '90*0, Vicenza, 1990

- have lower labour costs and less stringent environmental standards. Many competitors are also increasing the quality of their production and are also benefiting (in particular China) from the relocation processes underway in some important user sectors (footwear, cars and upholstered furniture). Italy holds a good position on foreign markets, with a share of around 20%, being the world's leading exporter, ahead of China and Brazil. In the second half of the nineties, the country which was most able to conquer new spaces on the world markets was China, which has now reached the second place in the ranking of the principal exporters, even though it is still far from the Italian sales values[112]. In addition, there has been a loss of market share by important competitors, such as South Korea or Taiwan.

Since the second half of the 1990s, many operators from other Asian countries have increased their presence in China. Brazil has also significantly increased its weight over the last decade, especially, like China, on exports of finished leather.

The restructuring of the district also concerns the settlements, with the transfer of the tanneries from the historic centre of Arzignano to the new industrial area; this makes it possible to remedy the slowdown in the expansion of the sector due to environmental reasons connected with production (anti-pollution regulations, quotas on the quantities of water available to each company, etc.). The Nineties were characterized by the massive influx of non-EU workers who found work in the district, to make up for the shortage of local labour and the problem of the ever-decreasing willingness of the local population to work in the tanning sector. At the same time, the experience of relocating production facilities abroad continued, while the ownership of the largest companies was concentrated in the hands of some local families.

The main actors of the district can be identified in the following relevant figures:

- groups, some of which are characterized by the presence of large families and projected at an international level, even if the companies involved do not exceed the medium size, as seen above. It is estimated that the main families of producers sell about a quarter of the production of the district[113]. Other groups are smaller in size in terms of the companies involved and have a lower international projection. Generally, the diversification within the group is horizontal, even if, since the nineties, this trend has been attenuated in favour

[112] Ibidem
[113] Fabris O., *Artisti e artigiani della pelle nel Veneto antico*, Milano, Editma s.r.l., 2005

of an expansion of the product portfolios of the single companies[114]. Their formation has determined a growing hierarchy of the local productive system and has been to the detriment of the smaller enterprises. On the other hand, the groups have played a positive role in the evolution of the district, contributing to the improvement of its image and acting as "pioneers" (leading companies);

- autonomous enterprises, generally full cycle, of medium and small dimensions, but also enterprises specialized in the retanning phase which, even if not full cycle, often sell finished products on the final market[115];
- subcontractors, who carry out one or a few operations on the raw materials supplied by the customers, up to the production of wet blue. In addition to some more structured and autonomous companies from the strategic point of view, there is a large fabric of very small companies, often family-run, which carry out specific processes and operate in conditions of greater subordination compared to competitors and are subject to strong price competition[116];
- commercial enterprises, born from the need to better control the outlet markets and the impossibility of increasing the number of production units, due to environmental limits. This has led to the creation of specialised functions in tanneries (some of which have also created a commercial enterprise), but has also generated space for the creation of commercial companies with the function of an interface between the markets for the purchase of raw materials/semi-finished products and the markets for the outlet of tanneries/end users. There are both traditional intermediaries, who deal with the pure intermediation between the seller and the buyer of the semi-finished product, and evolved intermediaries, who buy leather at a certain stage of processing (fur or wet blue), make it work in the district and then resell it as wet blue or finished leather.

4.2 The Pretto family: 60 years of history of the Pasubio tannery

In the province of Vicenza, in Arzignano and in the Chiampo Valley, the art of tanning leathers has very deep roots. It is important to know that the City of tanning has enjoyed, compared to other neighbouring centres, particularly in the late Middle

[114] Ibidem
[115] Foresti G., Trenti S, *Il Distretto della Concia di Arzignano*, op. cit.
[116] Ibidem

Ages, of not negligible importance, creating a fertile humus, flourished lushly in the fifties of the twentieth century[117].

If today the district enjoys a certain fame in the world, much is due to those who, in past centuries, but especially during the nineteenth century, engaged in various business activities. Thanks to the prodigious work of these people, the tanning art developed in the area of Arzignano. The entrepreneurial vein and spirit of sacrifice of the people of Arzignano has been manifested over the centuries through various arts and industrial activities: the renowned manufacture and trade of eighteenth century *pannilano*[118], the factories for the production of the mezzalana[119], those that worked the felt for the manufacture of hats and silk manufacture.

In Arzignano, until the first half of the fifties, it was still the hands of the man who, although using some machinery, carried out that complex of operations now mechanized. The tanning of hides was still considered a craft and had not yet assumed typical connotations of industrial activity[120].

The tannery was, therefore, in full evolution with new products and technologies supported by the chemical industry, which will dedicate specific research to it (tanning technology). The combination of these factors and the almost simultaneous invention of special machines such as the splitting machine, the shaving machine and the rosewood have made it possible to work, at the same time, a greater number of skins.

The ancient trade of tanning has followed an industrial model typical of the Italian economy, based on a district scheme dominated by small businesses, often family-run, which have been flanked by some larger realities.

In this valley, the Fratelli Pretto tannery began its activity in 1966 in Arzignano with the production and processing of leather for automotive, aeronautical and nautical use.

The history of the Fratelli Pretto Tannery (the Pretto Tannery brothers) stems from the desire to be one of the first Italian companies in leather processing. Its success comes from the sacrifice and entrepreneurship of the Pretto family, who worked tirelessly to create a company that has set the benchmark in terms of quality, innovation and reliability in the tannery sector.

[117] Micelli S., *Futuro artigiano, l'innovazione nelle mani degli italiani*, Marsilio, 2011.
[118] A soft wool fabric
[119] A blend of wool and cotton or wool and a synthetic fibre
[120] De Simone E., Ferrandino V., *L'impresa familiare*, Edizioni Franco Angeli, Milano, 2015.

The entrepreneurial spirit of the Pretto family is based on three generations that have committed themselves to creating an identity that today has become the reference point for quality, innovation and reliability in the tanning sector.
The history of Fratelli Pretto began in the outskirts of Arzignano by the ingenuity of the four Pretto brothers: Mario, Bruno, Lorenzo and Vittorina[121].
The creation of the first plant took place in the '50s when the four Pretto brothers, famous for children's footwear, decided to take the road of diversification and also devote themselves to upholstery, before moving on to the automotive sector in the following years.
The plant featured all the machines necessary for processing leather from raw materials to the finished product. The production was mainly focused on leather for footwear. A production of 3,000 pieces per day.
The success achieved in the national footwear market thanks to products such as suede leather for loafers without lining and white butts for children's shoes led, in 1966, to the entry into the company of Luigi Loiero, a graduate in chemistry from the University of Turin and Serio Ruffo and a well-known leather seller.
In those years the name was changed, and the Pasubio Tannery was established to replace the previous Fratelli Pretto company.
The choice of the name Pasubio came down from two reasons: on the one hand, to exalt the importance of the mountains, of the majesty and on the other hand to use, in Veneto, a name that was well known to the local inhabitants to create a spirit of belonging to the company.
In 1975 the family decided to open the ELLE-PI tannery, in order to use all the parts of a leather, including the splits with a daily production of about 40,000 pieces.
Pasubio has shown a constant growth during the '90s. The company has been able to increase its turnover even during the last difficult years thanks to the acquisition of a new customer, Bentley.
Today the Pasubio group consists of four companies:

- Pasubio Leather;
- Arzignanese Conceria[122];
- Master;
- 3P Mechanical Industry[123].

[121] Ibidem
[122] Company that deals with the colouring and dyeing of hides
[123] Company that operates in the production of machinery and automated systems for the tanning industry.

The company, which over the years has increasingly specialized in the automotive sector, has invested heavily in research and development, setting up a laboratory that today is among the most advanced in the industry. This has allowed it to anticipate the needs of the market by preparing a wide range of proposal and highly technological items to offer to customers.

Pasubio counts among its customers the major international car manufactures:

- Alfa Romeo,
- Citroen,
- Ferrari,
- Fiat,
- Ford,
- General Motors,
- Lancia,
- Mazda,
- Peugeot,
- Pininfarina,
- Saab,
- Jaguar.
- Bentley
- BMW
- Jaguar
- Lamborghini
- Land Rover
- Peugeot
- Porsche
- Skoda[124].

The passage of Pasubio from father to son is a very delicate moment[125] and must be managed over time, according to a precise strategic plan that allows business continuity or create the conditions for possible alternatives.

In addition, the generational transfer must include the strategy to increase the value of the company, namely the tangible and intangible assets that constitute it. Profitability and financial equilibrium are among the main indicators of synthesis

[124] Available on https://www.pasubio.com/en/products/automotive

[125] Piantoni G., *La successione familiare in azienda. Continuità dell'impresa e ricambio generazionale*, Etas Libri, Milano, 1990.

of the well-being of a company. However, the variation of the company's value over time, even if considering the methodological difficulties of determination, is certainly an indicator of particular interest, especially in view of the high incidence of intangible assets such as customer affection and location.
Furthermore, the creation of corporate value depends on many factors linked in a long chain in which each link can contribute to the increase in value, being neutral or destructive, in whole or in part, of the wealth created by the other elements.
The growing competitive pressure exerted by foreign companies also within our tanning market, together with the progress of its life cycle towards full maturity, drastically reduces the economic space for undifferentiated companies, in the medium and low range. In the same way, increasingly limited market space tends to be occupied by third-party producers who offer "simple" processing, who have relatively modest production capacity and who are progressively replaced by suppliers located in Eastern Europe or in the Far East. Cost competition is bound to be practically unsustainable for our companies, as is the attempt to maintain a somewhat protected position in local geographic markets. The companies that pass unscathed from the current process of rationalization of the sector, are those able, on the one hand, to oversee in an excellent way the stages of the production chain where the product acquires the most significant component of the value recognized by the market, on the other hand, to strongly differentiate its offer, through a product and a brand that best meet the needs of its specific market target. In other words, tanning companies will be able to succeed in the sector to the extent that they succeed in shifting the competitive comparison from the cost of producing the product to the value it creates for the customer.
The strategic need to oversee distribution requires two very specific conditions on tanning companies that want to continue to develop their creativity and brand[126]:

- a significant financial solidity that allows them to make significant structural investments capable of generating adequate returns of profitability only in the medium - long term;
- the maintenance over time of high quality and quantity levels of supply, without which investments in distribution would not be clearly justified.

[126] Ibidem

Sufficiently large volumes of production must be achieved, supply must be innovated rapidly on the basis of a constant understanding of demand trends and a sound brand policy must be implemented.
Ultimately, the success of tanning companies such as Pasubio depends on the ability to differentiate supply through five critical factors of value creation:

1) creativity;
2) launch and diffusion of the brand;
3) production control;
4) international presence;
5) integration in retail distribution[127].

The first critical factor for success, the ability to innovate products and leathers, naturally requires the presence of one or more people with great and technical skills. However, in addition to individual inspiration, the collections should be based on a consistent research of stylistic and market trends and the development of innovative solutions.
The second critical factor is the launch and diffusion of a brand. In order to successfully implement this objective, it is necessary first of all that the culture of marketing and market orientation is sufficiently widespread within the company.
The launch of the brand represents the fundamental condition to increase at least potentially the added value of the offer and to achieve significant results in foreign markets. However, it requires considerable financial resources and management skills; it is necessary to be able to make high investments in communication to be addressed through the channels most consistent with the positioning of the product[128].
Production control is a third critical success factor. In particular, it is crucial to have a production organisation that guarantees maximum speed of production, flexibility, production efficiency and product quality.
The fourth critical factor for success is the international presence, since the presence in foreign markets is the essential condition to be able to grow consistently.

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[127] Fontana F. – Caroli M., *L'industria della moda in Italia. Strutture del settore, dinamiche competitive e lineamenti di politica industriale.* op. cit., p. 356.
[128] Fontana F. – Caroli M., *L'industria della moda in Italia. Strutture del settore, dinamiche competitive e lineamenti di politica industriale.* op. cit., p. 356.

Moreover, the international dimension of the brand can in itself represent an element of differentiation. Finally, the presence in foreign markets offers the company the opportunity to capture different signals and trends, thus having fundamental knowledge for the innovation of production.
The critical nature of the international presence implies several problems: the definition of the brand's positioning in the various foreign markets, taking into account that, despite the emergence of "global" trends in fashion, there are still very significant elements of differentiation between consumers in different countries. The development of a network of agents able to operate at an international level and the determination of an adequate organizational structure to manage this network. The ability to connect with buyers in foreign markets where you want to enter. Direct or consortium participation in initiatives promoted by institutional agencies in foreign countries. The planning and implementation of direct investments abroad that may concern, on the one hand, the plant of production facilities, aimed at reducing the overall cost of production or to ensure the availability of an offer closer to the market outlet. On the other hand, the establishment of a network of sales points in foreign countries[129].
The fifth critical factor for success is the company's ability to produce a sufficiently wide and frequently renewed range of products to guarantee an adequate assortment of distribution centres.
Today, Pasubio, which generates most of its turnover by car, sees the market divided equally between Europe, Asia and the USA. The company has an internal department that produces cut leathers, pieces that are ready to be assembled for steering wheels or seats. The consolidation of existing customers and the acquisition of new markets in the car interiors sector is one of the company's priority objectives to be pursued, aiming at a constant increase in the quality and technology of its products in order to better contrast the competition of the so-called emerging markets.
Pasubio also produces high quality leathers for furniture, yacht interiors and fashion accessories. Moreover, it represents a company with a strong sense of environmental awareness and responsibility, which translates into precise choices and concrete actions: for example, the leather is finished using mainly ecological water-based products. Potentially polluting emissions are linked to two different

[129] Ibidem

wastewater treatment units to ensure non-stop production while providing the ecosystem with double protection in the event of a malfunction of one of the two units.
The company works following all the needs and desires of its customers, in fact an important feature is its systematic control of the various phases of the production process.
All this is based on precise procedures deriving from the combination of cutting-edge technology and the traditional art of leather processing.
It is the use of a special light leather, a type of leather obtained by making light products during the first stages of tanning that allows the use of a standard leather with good mechanical resistance. The weight saving is about 20%, without any impact on comfort and final strength[130].
The Pasubio tannery has always had the ability to intercept the tastes and trends of the moment, to adapt to a constantly evolving demand and above all to face the international markets and not be limited only to the domestic context. In this way, it allows to maintain a competitive advantage with respect to Italian companies in the same sector and companies from emerging countries, which, at the same time, can count on lower production costs.
The company has set up a trends department that constantly monitors trends in various markets - home, office, transport, fashion, art, contract design and many others - in order to anticipate the latest aesthetic demands coming from the automotive sector. Every year Pasubio prepares a book in which new colours, finishes and technological innovation are shown that become tangible in a new range of suggestive physical samples[131].

4.3 The advantages deriving from the process of internationalization

The export activity for tanning companies allows to seize an important series of opportunities for development and prosperity for the company. Many of them are easily identifiable and concern the results that can be obtained in the short and medium term in terms of turnover. Others are less immediate and refer to the

[130] Available on https://www.pasubio.com/en/products/automotive
[131] Available on https://www.pasubio.com/en/products/automotive

development of the company in the medium to long term, the increase in its competitiveness and the possibility of building barriers to competition[132].

Some of the advantages that can be achieved as a result of an internationalisation strategy are as follows[133]:

- increase in turnover, is the most obvious and immediate advantage; the sales of a company depend both on the competitiveness of the company itself, and on the size of the market to which it is directed. Undertake an export activity therefore allows the company to broaden its market base;
- increase in turnover: the additional sales that can be obtained on the foreign market are such as not to have a significant impact on fixed costs, such sales will increase the overall profitability of the company;
- economies of scale: the activity abroad ceases to be a marginal part of the overall activity of the company, this undertakes a process of growth in terms of size, supported by the growth of the market base, which allows it to access new financial resources and to exploit the advantages in terms of cost related to the size;
- risk diversification: export reduces the company's connection to a single market and allows it to overcome any periods of recession in individual markets;
- access to new business experiences: operating in different markets allows you to come into contact with new realities, new ways of operating, new successful ideas that can be understood and used both in your market and in other reference markets;
- face globalization with serenity: the strong globalization of markets has the direct consequence that no company can afford to remain closed in its market.

  The experience of competition on the international market, carefully designed and managed in the best conditions, allows companies to build the financial means and managerial skills to compete with foreign competitors in the domestic market.

[132] Gambino A., Di Pinto M., *L'impresa nei mercati esteri. Guida* all'internazionalizzazione. Wolters Kluwer Italia, Milano, 2016

[133] Manelli M., *L'internazionalizzazione d'impresa*, F. Angeli, Milano, 2017.

- increased presence in the Italian market: sales depend both on the size of the reference market and on the company's competitiveness vis-à-vis its competitors. The characteristics necessary for companies to compete on international markets, the experience, skills and resources acquired will bring an important competitive advantage over those companies that limit their area of activity to the domestic market. The countries most open to the world market have grown much faster than the less open ones; in particular, in developing countries that have oriented their economies towards a dynamic participation in trade, investment and technology flows, there has been a significant improvement in living standards.

Market integration driven by trade and investment has generated greater economic interdependence between nations, strengthening the links between developed and developing countries. Of course, trade and investment also multiply between developing countries. Freedom of trade and investment allows for the exploitation of the principle of comparative advantage, whereby countries and individuals develop and evolve when they use their own resources to achieve what they are relatively better at than others. When companies are free to specialise and trade, this allows them to exploit their strengths, capabilities and experience in relation to others, while freedom in trade and investment expands the supply of goods and services to businesses and consumers, allows investors to diversify risks, to channel resources towards more profitable uses, and to obtain capital at the lowest possible cost[134].

4.4 Internationalization as a future perspective

When it comes to international companies, most of the contributions relate to large companies. However, internationalization is not the exclusive prerogative of large companies, but, especially in a country such as Italy, where small and medium-sized enterprises are the backbone of the economy and where there is a high propensity for international trade, the issue of internationalization of SMEs takes on decisive significance. At the basis of this is the conviction that it is possible to

[134] Ibidem

apply to SMEs some of the theories developed for large companies, sometimes adapting existing theories and sometimes developing others.

According to Sciarelli, "International expansion can be defined as the direct policy to ensure systematic outlets abroad for products placed at home or directly in foreign countries"[135]. Valdani, on the other hand, proposes a proactive business model[136], where the main characteristic is heterarchy, a fundamental element for a business that intends to internationalize itself.

Rullani[137] refers to the transnational enterprise as a company that knows how to take advantage of the competitive coordination between business units located in different countries. Today, companies that have decided to differentiate and move away from the two traditional models of "exporting" and "classical multinational" companies must have a global perspective and verify their position in terms of global advantage in order to position themselves in terms of activities and locations in relation to the latter.

The process of internationalization of a company is not a direct process but requires time and a series of subsequent measures: the policy of market penetration usually follows stages with increasing degrees of commitment and risk. The difficulty of moving in an unfamiliar environment, the impossibility in many cases to predict the pace of development of sales, the need to begin to gain experience in the least risky way, are all elements that lead to the initial implementation of an export activity of finished products, and then move on to more stable forms of presence abroad[138].

The eighties and nineties represent the period of maximum development of the model of the Italian industrial districts: their productive structure is diversified in a wide range of activities in the light and traditional sectors, however strongly oriented to the export, like the leather sector.

The district has represented and represents an element of the recovery of the Italian economy, which today, however, can be an obstacle to change for the economy of Vicenza. The main difficulty is to rethink a successful model, questioning the production identities and economic institutions, which have accompanied one of the most important and lasting processes of development of the European economy[139]. Under this light, the current dynamism of these activities is not taken

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[135] Sciarelli S., *Economia e gestione dell'impresa*, Cedam 2001, pag. 292
[136] Valdani E., G. Bertoli, *Mercati internazionali e Marketing*, Egea,2004
[137] Rullani E.- Grandinetti R., *Impresa transnazionale ed economia globale*, Carrelli 1996
[138] Sciarelli S., *Economia e gestione dell'impresa*, op. cit., p 295
[139] Acocella, N., *Politica economica e strategie aziendali*, Bari, Carocci, 1999, p. 64

into consideration, which leads to evident results in export activities and the ability to anticipate, with appropriate strategic choices, future trends and profound organizational changes as a response to the discontinuous dynamics of the economy.

In the turn of the new century, the emergence on the world scene of new geo-economic areas, long excluded from the international division of labour, defines the need of the Italian economy, like that of Vicenza, for a new and more sustainable path of development, dictated precisely by this increasingly pressing competition from emerging countries with particular attention to the new economic power such as China. After 2001, the year in which China joined the World Trade Organisation, the international players became aware of the dangerous situation, because it immediately became clear that the Asian giant, for its size and its state-communist apparatus of support for its enterprises, was an unprecedented competitor in history, able to develop a strongly asymmetrical competition on a global scale, which affects both developed and developing countries[140].

Italy, with its traditional sectors of Made in Italy and its districts that have to face a commercial overlap of product with China, is particularly affected and damaged by Asian asymmetric competition and the phenomenon of counterfeiting, widely practiced by Chinese companies.

To this new general world condition is added the rapid multiplication of regional free trade agreements which, far from penalizing countries outside these agreements, have certainly contributed to expanding intra-area trade, but in this way also to increasing income, imports and foreign direct investment in the area. Furthermore, the shocks of the 2000s and the recent economic and financial crises which have affected the world economy since 2007, strongly destabilizing the economy of the developed countries, making them much more dependent on the new areas[141].

Since the second half of the 1990s, industrial districts have been confronted with a number of major challenges and new problems:

[140] Ibidem

[141] Tattara G., *Il piccolo che nasce dal grande. Le molteplici facce dei distretti industriali veneti*, Milano, Franco Angeli, 2001

- the growing shortage of skilled labour and the massive use of immigrant workers, with a lower level of schooling which sometimes also poses social problems;
- the small and medium size of enterprises, which limits the possibility of investing in research, in internationalization projects and in projects to strengthen distribution channels;
- the growing problems of generational turnover at the top of district businesses, which are essentially family businesses;
- the limited use of external professional managers, competent on an international scale;
- the desire to undertake and sacrifice oneself, as well as the attitude to business risk, seem to have disappeared in the new generations, with the spread of economic well-being;
- the price of oil and energy in general have increased a lot, causing the costs of companies to rise compared to those countries less dependent on foreign countries for gas and oil;
- the advent of the euro which, contrary to expectations, has proved to be a rather strong currency against the dollar, thus encouraging investment, but discouraging exports and the related implications with the Chinese currency, anchored to the exchange rate with the dollar.

The years of crisis that Italy is going through are not only attributable to the Italian economic model of the industrial districts, but more precisely to the presence of an economic power like China[142].

In the face of great economic changes, in the presence of a globalized, interconnected economy, where distances have been cancelled out thanks to communication systems, nations have been forced to open up their economies internationally to a real process of internationalization.

Internationalization is a process through which a company, a network, an economic system tries to expand the scope of action, relations and confrontation outside its national borders[143].

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142 Fortis M., *Le due sfide del Made in Italy: globalizzazione e innovazione*. Profili di analisi della Seconda Conferenza Nazionale sul commercio con l'estero. Il Mulino, 2005.

143 Manelli M., *L'internazionalizzazione d'impresa*, F. Angeli, Milano, 2017

For more than two decades, the latter has been the dominant analytical reference, capable of reconciling different economic and business theories on the determinants of direct investment and, more generally, on the foreign activities of multinational companies. The leather sector is today, as we have seen, highly internationalized and suffers from global influences: it has a considerable exposure to foreign markets, both in terms of outlet markets and supplies. The latter are for the most part located in emerging countries and/or countries rich in livestock. The downstream sectors of the leather industry are also increasingly presenting open and internationalized production networks. It is therefore necessary to consider the emergence of new competitors such as China and India, whose growth rates are clearly driven by an export-led model, as well as the need to obtain raw materials.

The District of Arzignano has so far been successfully involved in these processes, exploiting the typical strong points of the district linked to the type of division of labour, to the wealth and heterogeneity of the players, to the capacity of logistic management and, finally, to the collaboration with the chemical industry to produce better and less polluting products and, with the machine manufacturers, to develop process innovations.

Since the nineties, however, the tanning sector has also been involved in the phenomenon that is part of production internationalization, in addition to the proven and most used commercial internationalization.

The sector has seen the participation of medium-large enterprises of the most dynamic local systems in a wider division of labour outside the district, through joint ventures, alliances, international subcontracting networks.

This new policy of alliances is able to exploit the advantages connected to the spatial differentiation of competitive conditions (environment, resources, costs, infrastructure and knowledge). This creates an objective convergence of the neo-district model with the process of global expansion of multinational companies, which is defined as a meta-district. This transformation does not translate into a renunciation of manufacturing specialization or the abandonment of the "made in Italy" sectors, but into a widening of diversification and of the range of companies. The attempt of the District's companies to continue to "serve" customers who in the past operated in Italy or in European countries and now produce a good part of their production in countries with low labour costs, has resulted in an increase in the District's propensity to export and in the "reorientation" of exports towards emerging markets. In the Chiampo Valley District, export flows continued to grow towards Hong Kong, Poland and China, namely in those countries characterized by the presence of Italian companies in the leather sector client sectors.

The good performance achieved in recent years by the District in Central and Eastern Europe and East Asia has partly limited the losses incurred in advanced markets. Production internationalization has been a modest phenomenon, not only towards China, but also in other areas, preferring other less risky forms of investment, and has occurred in two main phenomena:

- to reduce the costs of the upstream stages of processing, towards greater control in the procurement and quality control of hides and for all those more polluting operations of tanning, in areas where control is less rigid (such as Brazil) and the hides are aimed at export;
- the second reason that has guided the relocation is the need to follow the outlet market, the so-called "follow the client strategy"[144].

The ultimate goal for leather companies is the sale of hides in foreign markets and with logistical advantages such as the improvement of the ability to serve customers in these markets, protect themselves from exchange rate fluctuations and, in particular, from the appreciation of the euro.

Another strategy adopted by some operators is to move even the most delicate and downstream stages to emerging countries in order to better serve these markets. This is the strategy pursued by the Rino Mastrotto Group, which supplies the American market through the Brazilian plant which, in addition to the first stages of the production process, also produces finished leather.

Another case is that of the Ambra tannery of the Dal Maso Group present in South Africa with the subsidiary Mario Levi Manufacturing South Africa Ltd, which carries out the activity of finishing and marketing of car hides.

The relocation of the production of some articles, however, has not caused the closure or downsizing of the importance of the Italian tannery responsible for the proposal of cutting-edge and high-quality articles[145].

The investment in China, both as a commercial hub and as a production activity, has, however, a very high level of complexity, often not within the reach of smaller companies.

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[144] Tattara G., *Il piccolo che nasce dal grande. Le molteplici facce dei distretti industriali veneti, op. cit.*

[145] Brunetti G., Euro e distretti industriali, Milano, Franco Angeli, 2000

In addition to the two most important reasons for relocation mentioned above, there are others, such as the opportunity to acquire new activities and production skills within the Districts, representing a path towards repositioning in the international division of labour and a push towards the processes of innovation and industrial reorientation.

Delocalization must be seen as an evolutionary perspective, where innovation acquires an increasingly important role: in many cases it is necessary to lose something, such as activities with low qualification and easily transferable, but to gain others, such as those based on innovative services, qualified work, creative capital.

In support of internationalization is the strategy of worldwide repositioning of businesses and local economies, in which the extension of the networks of division of labour is the basis for achieving greater economies of scale in the creation and use of productive knowledge.

This aspect is little considered, but it can represent a turning point for the development of the Vicenza economy. If relocation is seen in this light, we realize that it is not only a necessary evil, but a tool to grow in a competitive scenario, where what matters is no longer only the ability to do production, but increasingly the ability to spread the intelligence accumulated in businesses and local society even in productions made by others.

This means not only transforming and selling products, but also ideas, projects, know-how, technologies, services and organisational solutions.

The experiences of relocation of the Vicenza district have, however, highlighted that in the countries of destination the problems of a cultural, infrastructural and institutional nature cannot be solved individually, especially when it is a small or medium sized company that invests.

The lack of cooperation between companies and the scarce support of national economic policy are elements to be overcome through a district management initiative (in the economies affected by relocation), a cooperation not only of companies, but with the participation of the cultural and institutional contexts in which they operate. A particular phenomenon, specific to the Chiampo Valley skin district, has been defined as "reverse relocation". The district did not show a great propensity to relocate tanning production to areas with lower costs, but preferred to maintain that link with the territory, so the workforce was attracted by the job opportunities that the area could offer, leading to a shift of human capital within the same.

The district of Arzignano has therefore developed from proto-industrial activities to take the form of a "District", with a significant density of small and medium enterprises and a strong specialization.

There are many reasons for the lack of recourse to relocation, compared to other Italian manufacturing sectors, which have largely relocated their production abroad:

- the phenomenon of *embeddedness* of *know-how*;
- the Marshallian external economies;
- the social roots of entrepreneurs.

Embeddedness refers to the existence of tacit knowledge rooted in the district and the skills of professional workers in companies. The difficulty in codifying this knowledge makes every investment operation abroad risky.

The territorial *embeddedness* of the district is mainly linked to the tacit skills possessed by senior professional operators and the transfer of their skills to new workers is slow and based on long company internships[146].

The complexity of the plants and the sequence of operations is the greatest risk factor, which hampers local companies in activating relocation paths.

The second element, represented by external economies, explains that the particular dynamics of internationalization of the tanning district concerns competitiveness by "District effect", that is the presence of external economies not immediately transferable to developing countries. The division of labour activated in the eighties and nineties has favoured economies of scale in the various production phases.

To be maintained, these economies should be accompanied by a complete relocation, not only of the final companies, but also of their subcontractors, a process that is difficult to achieve. Innovation in the mechanization of tanning processes, brought by small local machinery manufacturers, has always given a formidable advantage to the companies of Arzignano, such as to compensate for the higher labour costs incurred by the companies.

Finally, to bind the companies to the territory there is not only the qualified work team existing in the district and the presence of specialized subcontractors, but there is also the existence of a collective purifier. It is clear that those who wish to

[146] Fontana G.L., Roverato G., *Processi di settorializzazione e di distrettualizzazione nei sistemi economici locali: il caso Veneto*, Bologna, Il Mulino, 2001

disconnect from this utility will have to provide on their own to bear the high costs for the purchase of new purification plants. This constraint, beyond the more or less restrictive anti-pollution laws in force in the host country, could be overcome if the relocation were to take place through the transfer of a significant number of companies able to share the costs of a new purification plant.

- *The rootedness of entrepreneurs in the local social network.*

The third element concerns the low propensity of local entrepreneurs to move abroad. Small businesses, when internationalized, suffer greatly from the *liability of foreignness*. The small family business is not able to amortize in the short term the costs of a new investment: too many risks would be encountered, not knowing neither the language nor the local culture. This trend would seem to be at odds with the great international openness of the district, in relation to its export flows, which see companies in Hong Kong, China, Romania and Spain as their main customers. Many major international brands of clothing and leather goods and footwear produce in the East but buy the raw material in Vicenza. Finally, the "industrial atmosphere" in the District of Arzignano, formed by the best engineers designing tanning machinery, the high professionalism of companies specialising in chemical products, a permanent school, such as the "Galileo Galilei" Tanning Institute in Arzignano, an efficient purification plant for tanning waste, build an integrated system that is difficult to duplicate.

These virtuous phenomena, however, correspond to signs of criticality that not only persist but are frequently exacerbated, resulting in a weakening of the production organization of many Districts: it seems increasingly necessary to improve the interaction between companies, local authorities and intermediary subjects of representation, which are required to provide faster services and higher skills, to support companies to deal more adequately with the complexity of the markets[147].

The serious tensions on the financial markets have led to greater prudence in the evaluation of the risks, to a lesser willingness of the banks to provide financing and this has produced a crisis of liquidity in many companies, above all those of smaller dimensions, which more than others suffer from the enormous delay in the collection of the credits. The resulting liquidity crisis has partly undermined the driving force behind the industrial districts[148].

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[147] Visconti F., *Le condizioni di sviluppo delle imprese operanti nei distretti industriali*, Milano, Egea, 1996

[148] Ibidem

The generational shift, the raising of the level of skills within companies, the growth of business culture and the processes of modernization of business organization are still critical variables that many district companies cannot manage effectively[149].
In a labour market where the prospects for new hires are very limited, however, in many production areas the lack of qualified personnel and managerial figures persists which, together with the problem of the generational transfer and the limited corporate culture, already mentioned, hinder the development of many district companies. Undeclared work, evasion and unfair competition from irregular companies. These criticalities, together with other phenomena related to globalization that have limited the competitive advantage of the territory, have reduced the "District effect", so that the greater profitability and productivity generated within the agglomerations tends to fade, if not even to cancel out. This "District effect" has not disappeared everywhere, on the contrary, the ability to anticipate future trends and profound organizational transformations with appropriate strategic choices is noted as a response to the discontinuous dynamics of the economic situation. The central point, however, is the fact that this situation has been going on for some time now, poised between recovery and downsizing. Overall, a further qualitative leap seems necessary, which is oriented towards the use of new instruments such as *private equity*. Private equity funds are becoming increasingly important on the national and international economic scene for their role of intervention in support of companies of all sizes in order to develop their business.

4.5 CVC Capital Partners and the control of the Pasubio Group

As far as the Italian tanning sector is concerned, especially with reference to the Chiampo Valley, there has been a strong propensity for short-term relations through trade with China, which constitutes the real backbone of the sector's economy.
China, as the main destination of the Italian tanned, has determined the positive trend of the sector, even in a period of deep recession. What did not happen,

[149] Piantoni G., *La successione familiare in azienda. Continuità dell'impresa e* ricambio generazionale, Etas Libri, Milano, 1990

however, was the relocation to China, except for a few bankruptcies and a few successes. There are several reasons why tanneries did not leave the country in the same way as manufacturing did:

- to make a tannery there is a need to invest a lot of money, not only related to investment in real estate, but also related to the purchase of stocks, of the warehouse stock;
- in the nineties in Italy the tanning market had no major problems, so the idea of investing in a country so far away to produce leather, when it was easy to send them by ship, was not much taken into account;
- in the typically Italian mentality, the investment in China would have involved a probable closure or a probable downsizing of what was the national production;
- finally, starting from 2005, the conditions in the tanning sector have worsened due to the difficult release of authorizations.

In recent years, the international competitive scenario has undergone a phase of profound transformation: after three decades of uninterrupted growth, this has led to the questioning of the role played by the manufacturing sector in the so-called industrialized countries, with a shift in the centre of gravity of world production towards emerging countries, particularly those in Asia.

According to some authors, the district of Vicenza, therefore, which was an advocate of the recovery of the Italian economy, was an obstacle to change for the economy of Vicenza, as a limit and difficulty in rethinking a successful model, questioning the production identities and economic institutions that accompanied one of the most important and lasting processes of development of the European economy[150].

During the first decade of the new century, the emergence on the world scene of new geo-economic areas, long excluded from the international division of labour, has defined the need of the Italian economy, like that of Vicenza, for a new and more sustainable path of development, dictated precisely by this increasingly pressing competition from Asian countries, including Taiwan, South Korea, India and, especially in recent times, China.

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[150] Weber M., *Due anni in Cina, Opportunità di business, scenari in evoluzione*, Etas, 2008

To better understand the choices made by the Italian tanning sector, the possible opportunities to be seized or the critical issues to be resolved, it is necessary to examine the case of the Pasubio tannery and the private equity firm CVC.
CVC Capital Partners is a British financial company specialising in *private equity* in sectors such as consumer goods, financial services, telecommunications and pharmaceuticals. It manages more than $52 billion in assets between Europe and Asia, with an investment capacity of $109 billion.
CVC was founded in 1981 as a subsidiary company of the *Citicorp Venture Fund*[151], with the aim of investing in risk capital in *leveraged buyouts*.
In 1993 the new independent private equity company, *CVC Capital Partners*, was founded, which after only three years collected its first fund of € 840 million dollars. In 1998, the fund exceeded three billion dollars, making CVC one of the largest and best-known private equity companies in Europe. In 2001, CVC began raising funds for its third investment fund, which brought it to Asia with a $750 million fund focused exclusively on investments in Asian companies.
The rise of CVC began in 2006 with the acquisition of 63.4% of the shares of the Formula One group, owner of the Formula One motor racing championship. In 2013, it took over for 1.13 billion euros Cerved, the largest database of economic and financial information on Italian companies.
In 2015, CVC invested in Growth Partners in Wireless Logic, Europe's largest provider of machine-driven services. In the same year, again, CVC acquired 80% of Sky Betting & Gaming [152] and the German perfume dealer Douglas AG.
In 2016, it took over the German betting operator Tipico in the youth sector, followed by Sisal, a leading Italian gaming operator. In April 2017, it acquired 80% of Breitling's watch company while the other 20% of the Swiss company remained in the hands of the Schneider family. In the same year, it acquired $703 million from Teva Pharmaceutical Industries, which manufactures products dedicated to women's health, from contraception to menopause and osteoporosis.
In June 2018, CVC, which heads a consortium with other funds, acquired control of the Italian pharmaceutical company Recordati for 3 billion lire, acquiring 51.8% of Fimei, the holding company of the Recordati family (the brothers Alberto, Andrea, Cristina and Giovanni's widow, Hillary).

[151] The investment company created again in 1968 by the American banking giant Citicorp
[152] Canadian gambling company based in Great Britain

In the Chiampo valley, in 2017 an Italian company decided to open up to a *private equity* fund when CVC bought Pasubio, specialised in leather for the automotive industry, for almost 300 million euro.
The Pretto family, owner of the company since 1950, has remained in the role of minority shareholder, in a sector in fact linked to the traditional and family management of the company, not inclined to innovative formulas of access to credit, especially to sell the company created with their own hands.
The case of the Pasubio Tanneries is interesting because it underlines how a healthy and growing family-owned company is acquired by an Anglo-Saxon fund, *CVC Capital Partners*, in order to further develop its business in emerging markets.
The family owner, considering that it's a family management model, which had allowed the company to grow and reach a significant size in the district of Vicenza, could hardly guarantee further development and expansion on an international basis. For this reason, the decision to seek an important financial partner was taken.
The consideration that led the Pretto family to turn to CVC is given by its management model, seen in recent years, as a possible limit to the prospects for development of the company.
The choice of the family has thus been oriented towards the sale of the company to pursue a new prospect of growth and in any case maintaining a minority stake in the future shareholding.
The choice of CVC depended on wanting to focus on a company with excellent performance and significant growth prospects, especially in new international markets and in a long-term trend.
The role of the family remains important in any case even in the new phase with responsibility for operational management entrusted to a member of the same family as Managing Director.
This choice of CVC is a sign of confidence on the part of the new shareholders compared to the previous owners who had led the company to excellent results. The intervention of CVC, which is exclusively responsible for the choices of strategic direction, has provided for the entry into the company, with the aim of initiating a strong process of managerialization, a new management team, from the figure of a new CFO, Dr. Giuseppe Viola, with a consolidated experience in companies that have turned to private equity.

The management control system has been completely revised in order to provide and implement in a few months monthly balance sheet closures with related economic and financial analysis reports. In this evolution, a new financial culture was promoted with a sharing of the value of some specific KPIs, including in particular EBITDA.
Luca and Alberto Pretto, of the Pasubio Tannery, saw the operation as an instrument of growth for their company. The operation represents a "turning point" for Giancarlo Dani, president of the group of the same name, born as a small family-run tannery in 1950 and now supplier of high-quality leathers to prestigious fashion, clothing and major car manufacturers. The objectives of the Pasubio Tanneries are to grow in the automotive leather sector, to further develop their business through CVC, which has a great deal of liquidity at its disposal and represents the possibility of a relaunch to invest, modernise, strengthen and confirm its presence in the territory.
The search for change is crucial because without opening the Vicenza company, it risked remaining in last place compared to competitors in the Vicenza district. The financial crisis and the lack of liquidity due to it have changed the way of thinking with respect to the access to credit of the Pasubio Tanneries.
One year after the entry of the Fund, the company's results have increased. Last year's consolidated turnover reached 313 million euros and the number of employees rose to 1022 from 740 in 2017. More in detail, the operating result exceeded 40 million euros with a cash flow generated of 38 million and investments have doubled compared to the historical average of the company[153].
The Fund is destined to remain in the company for several years and the exit channel - sale to another fund rather than sale to another company in the chain rather than listing on the stock exchange - will depend heavily on the strategic choices that will be taken by the fund itself in the coming years.

[153] Available on https://www.aifi.it/private_capital_today/1126958-conceria-pasubio-il-primo-bilancio-con-cvc

Chapter 5

The case of Rino Mastrotto Group Spa

Overall: 5.1 The strategy of diversification for the growth of *family businesses*. 5.2 The competitive scenario of the Arzignano district: the history of Rino Mastrotto Group Spa. 5.3 The case of Rino Mastrotto Group and NB Renaissance Partners.

In the fifth chapter an analysis of the development of the tanning pole is linked to the production force of the district of Arzignano and the philosophy of Made in Italy. The companies of the Chiampo valley have shown a deep aptitude towards the diversification of their core business. In 2019, Rino Mastrotto Group decided to choose as a partner a fund for a *private equity* transaction that will allow the group greater liquidity.

5.1 The strategy of diversification for the growth of family businesses

Family business crises in recent years have become deeper and more frequent and diversification has become a key way to protect family wealth. If one sector suffers a recession, activities in other sectors can generate funds that allow a company to invest for the future while its competitors are retreating[154].

Over time, systemic conditions begin to change and make it impossible to maintain autonomous control of the *family business*.

Indeed, the need for new resources - managerial or capital - forces the entrepreneur to make new choices. This is the moment when the company opens up to third-party capital and professional management, an antechamber of a different business model, timeshare, no longer familiar or, in any case, certainly not purely familiar. In essence, according to this vision of the family business model, there comes a moment in its life cycle in which you are forced to abandon the initial structure

[154] Kacharner N., Stalk G., Bloch A., What you can learn from family business, Harvard business review, November, 2012.

because, in order to grow, there is a need for new financial and managerial resources that can no longer be provided by the founding family of the company.

Diversification, in its various forms, is nothing more than a strategy aimed at achieving value creation. Even if it is not the only way, many companies resort to diversification despite the risks and uncertainties that characterise its results.

Although the theme of corporate growth and strategy has been studied extensively over this century and the last three decades of the last century, the management literature does not yet offer a shared view of typical business growth models and the connections between these growth paths and diversification[155].

Diversification strategies therefore play a fundamental role in guiding business behaviour. They should be divided into two macro-categories according to whether the strategy has as its object the product portfolio offered by the company or the market in which it offers its products and services. If in the first case we speak of "product diversification", in the second we speak of "geographical diversification" or "internationalization". Usually, the first of the two typologies is to be traced back to the company's willingness not to make its own cash flows depend, and, therefore, the profits, on a single family of products (i.e., the risk diversification). The second, on the other hand, is usually to be traced back to the desire not to depend on a single market or, more simply, to expand one's own reference market as a result of an excess of production at the domestic level or in the markets in which the company is already physically present[156].

With regard to product diversification, a company diversifies by introducing a new product into its product portfolio.

In this case, the company faces a certain level of risk and uncertainty from both a strategic and a financial point of view: the reason for this is the risk and uncertainty that characterizes an investment in a business that is not well known to the company, as well as the difficulties associated with having all the resources necessary for its implementation.

Precisely in light of the risk and uncertainty that characterize growth, this strategy must be planned through a complex decision-making process that involves the use

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[155] (Coad e Guenther, 2014)

[156] Fontana, F., Strategie di diversificazione e creazione di valore, F. Angeli, Milano, 2010

of resources specifically dedicated to expansion[157]. Growth can be pursued through an excess of resources (human, capital, material and immaterial) that the company knows it can employ, so as to exploit as much as possible the benefits in terms of returns. This excess of resources, where present, will influence the choice of the most appropriate instrument for diversification.

For example, if the company does not have sufficient resources to operate autonomously, the use of a partnership could be the best solution, resulting in diversification through the so-called inorganic growth. Therefore, inorganic growth is the one through which a company chooses not to operate alone, conferring along with others (whether they are partners or acquired) the resources and skills necessary to penetrate the target business. In this case, the intent is to enter promptly into possession of new resources and skills relevant to the value chain that the company does not want to create independently.

The other possible solution is organic growth, namely the process by which the company enters a new business autonomously, repositioning an existing business unit or creating a new one. It can be said that, in this case, wanting to operate without the help of anyone else, the intent is to be able to take over all the resources and capabilities of the value chain deemed necessary to operate in the target business.

In order to fully understand the concept of diversification, it is necessary to examine the reasons that lead the company to this strategic choice.

In particular, the first studies on this subject have highlighted four essential reasons:

- the general environment in which the company operates (i.e. political, economic, technological, social and institutional);
- the competitive environment in which it operates;
- the specific characteristics of the enterprise;
- the performance of the company.

In general, when the sector in which the company operates offers a low or insufficient level of profitability, diversification is a tool through which to solve the

[157] For example, hiring and training of personnel specifically employed in the expansion project; or, again, investment at organizational level for the coordination of business activities between different units of the enterprise.

problem of performance collapse. This means that its managers will have to search for and identify one or more sectors or markets, naturally characterized by a certain degree of current or potential attractiveness, in which to concentrate their attention and future investments thanks to an excess of resources that the company is still able to direct elsewhere than in its core business.

The process of diversification leads companies to enter new areas of activity or business with consequent major changes in the organizational, administrative and managerial structure of the company. Diversifying means expanding the scope of the company. The range of action is that which, in Anglo-Saxon terminology typical of management literature, is known as the scope of business activities.

A wide range of operations at product level, however, allows it to benefit in terms of competitive advantage from carrying out internally many of the main activities related to the implementation and marketing of the product, as well as being able to benefit from a more or less considerable expansion of its offering.

If it were possible to take advantage of the exploitation of the various interrelationships that could develop between the different geographical areas, sectors or market segments, the company could also benefit from greater market power and, therefore, have greater weight within the value chain (Porter, 1985), as well as obtaining various economies, the result of greater ability to coordinate between the various activities, business units or geographical areas (e.g. economies of scale, scope, experience and / or learning).

However, a wide range of operations implies a significant increase in costs. On the one hand, there are clear benefits for the diversified enterprise; on the other hand, there is a difficulty of action due to the more or less extensive ability of the enterprise to coordinate its moves and activities.

In the case of different businesses, absorption capacity plays a crucial role in the success of the transfer; to this, however, it is necessary to add the causal ambiguity that often ends up characterising the process, an element that makes it complex to modulate the use of resources and capabilities in areas of application other than those of origin. Moreover, at an overall level, whatever the type of diversification, there will undoubtedly be an increase in governance and coordination costs, since the company's greater scope of action leads to greater management complexity: this means that the synergistic benefits deriving from expansion can be considerably reduced compared to the higher costs originating from expansion.

Production diversification is fully achieved when new productions are not similar to previous ones both in technological and marketing terms[158].

There are two different development strategies:

1) the first is called lateral diversification, based on the existence of a link, in technological or marketing terms, between old and new productions;
2) the second is called conglomerate diversification, characterized by the absence of any link between existing and new activities[159].

The relations between the company's products can in fact be traced back to four different situations:

a) similar products from a technological and marketing point of view;
b) similar products in technological terms but not in marketing terms;
c) similar products in terms of marketing but not in terms of technology;
d) products without any technological and marketing affinity.

In the first case, an integrated horizontal development is implemented, in the second and third a form of lateral diversification and in the last case a conglomerate diversification[160].

The reasons for choosing a diversification strategy can be many and not always linked to the desire to ensure a rapid growth of profits.

The most frequent justification for this decision is that it is impossible to expand satisfactorily in a sector that is considered to be saturated and that, therefore, the search in other markets for more favourable opportunities for an increase in turnover. It must be taken in account the advantages of adopting such a strategy in terms of stabilizing incomes and reducing the overall management risk.

The diversification of activities is accompanied by diversification of market risks, as each output will be subject to current risks in the particular market for which it is intended. As a result, the ups and downs that may occur from time to time in each industry are better balanced in a diversified organization. This strategy can mitigate

[158] Sciarelli S., La gestione dell’impresa tra teoria e pratica aziendale, Cedam, Milano, 2014, pp. 112-113
[159] Podestà V., Strategie dell’impresa, pp. 9- 44.
[160] Sciarelli S., La gestione dell’impresa tra teoria e pratica aziendale, Cedam, Milano, 2014, pp. 112-113

the consequences of harmful events by offsetting the more or less favourable trends that could occur in the various markets served.

Its implementation is linked to generally dissimilar processes depending on the type of development. If, in fact, the company pursues a lateral diversification of production, it is more likely that the strategy will be implemented through the internal expansion of the company organization, namely through the creation from scratch of plants, administrative and distribution units, research laboratories, etc.

In the case of conglomerate diversification, on the other hand, the most frequent hypothesis is that of a business acquisition plan and the formation of a holding structure. In fact, given the substantial differentiation between old and new sectors, it is difficult to assume an expansion from within. The reduced technological and marketing assets possessed by the management will lead to the search outside the opportunities for inclusion in completely different productions.

Private equity investments are the only way to help *family businesses* implement diversification policies as quickly as possible.

The *private equity* tool allows *family businesses* to grow and open up to new prospects and inaccessible objectives without the support of such investments.

Empirical evidence has demonstrated that in recent years companies financed by large institutional investors have performed better than other companies, without neglecting the positive effects that the development of a company has on the national economy, primarily in terms of increased employment and investment.

These activities therefore not only have the benefits of all categories of alternative investments, such as high potential returns and the possibility to diversify the portfolio, but also have clear social benefits. Fortunately, most investors and politicians have become aware of the importance of this form of investment in the overall development of our country, in overcoming the crisis and economic stagnation, and, therefore, there is a greater focus on these tools.

It is also worth pointing out that technology and innovation are now a source of competitive advantage and differentiation for companies in all sectors: in this context, it is clear that venture capital funds are central to the process, which, by carefully studying the market, identify and support companies whose innovation projects are promising. The funds concretely support the companies financed, accompany them in the various phases of the development of innovation, not only by providing capital and experience, but also by creating contacts with the markets of outlet and supply, synergies and providing suggestions in strategic choices and in the marketing of products.

Among the various types of existing funds, it is worth highlighting the differences between international and national funds. International funds are typically of considerable size, can count on large capital injections and obviously have greater opportunities for profit to be seized on different markets and on various geographical contexts, having the managers a better view of the various dynamics at the international level. They prefer to invest in larger companies, because this allows them to make greater use of economies of scale and thus reduce costs. On the contrary, national funds do not have the means to make investments of this magnitude and managers, therefore, prefer investments in smaller companies.

Even though these funds have a narrower scope, they are still indispensable and efficient, especially in a scenario such as the Italian one, which is characterised by family-run businesses, whose needs can sometimes be understood by local operators.

Large international funds often operate through local advisors to whom they do not endow a predefined initial patrimony but attribute it gradually on the basis of the various investment opportunities that the advisors identify in their territory. In this way, the potential for return is pushed to very high levels, not only because of the greater opportunities that can be presented to funds so well distributed, but also because each advisor is in competition with others and the fund will prefer the granting of assets to advisors who will be able to identify the best investment opportunities, with greater prospects for return.

5.2 The competitive scenario of the Arzignano district: the history of Rino Mastrotto Group Spa

The district of Arzignano, in recent years has suffered a decline in turnover, however, has proved to be much more contained than other tanneries in the Chiampo Valley. The best evolution of Arzignano's turnover is testified by the presence of a significant nucleus of companies (more than 45 subjects) capable of capturing an increase in sales of no less than 16.1%. Also, in this district, however, there is the presence of companies in considerable difficulty, which have shown significant reductions in turnover, not less, for at least 45 companies, than 26%. The best growth performances of the companies of the district of Arzignano seem to be due only in part to the results obtained on foreign markets or to the diversification of some groups towards the production of other articles.

The strength of the Vicenza tanning district lies, first of all, in the organisation and division of labour among the various players. Over time, the organization along the chain has allowed the district to achieve a high level of flexibility at relatively low costs.

The advantage of the district organization has been flanked by that resulting from the strong heterogeneity of the actors, which further increases the flexibility and range of supply. In fact, the large groups are flanked by a large group of highly specialized medium and small enterprises, able to meet the needs of the market.

The development of this tanning pole is directly linked to the need for high quality standards expressed by the Made in Italy brand of footwear, clothing and furniture: national demand has raised the level of tanning production, has determined the flexibility necessary to follow the changes in the market and has allowed growth with the increase in demand for leather. This has favoured the competitiveness of the tanning pole of Arzignano at an international level and in the offer of more sophisticated and diversified articles.

Arzignano has in fact demonstrated an excellent ability to diversify its core business to take advantage of development opportunities in certain downstream sectors.

The district's specialization in furniture, which has also required changes in the type of leather processing and machinery, is relatively recent and is the result of a conversion that began about twenty years ago.

Among the many tanneries in Arzignano a strong group is represented by the Rino Mastrotto Group. The group's history began in the 1950s with the purchase of the Aurora Tannery and the start of the first production phases, which in the first phase focused on the footwear and clothing sector, and then moved on to the production of leathers for upholstery.

In the Seventies the number of subsidiaries had grown and included various and diversified offers, specialized in the final product but integrated at the production level to enjoy synergies.

At the end of the nineties, with the merger of the main companies (Calbe, Basmar, Galassia, Pomari and Brusarosco), Rino Mastrotto Group Spa was established with a structure of different divisions according to the production line. The group then continued its expansion by establishing the company Mipel Spa (which recently began a phase of liquidation of all assets) and acquiring the tannery Pizzolato, the oldest factory of the post-war period.

Over the years, with subsequent company acquisitions, a group corporate structure took shape. In this initial phase, the company works and produces, then, leathers for furniture of medium and low quality as is the case for most of the activities in the sector, given the important demand of both the domestic and international market. These have been decades of great commercial expansion, which goes hand in hand with an increasing specialization in particular productions and quality, thanks to internal research and the support of external laboratories.

At the beginning of 2000 a process of reorganization started within the company, due to a growing and increasingly fierce foreign competition, mostly Chinese and South American, which markets the same products at significantly lower prices. This advantage of the competitors is made possible by the aid of their own states, by the low cost of labour and by the low or absent costs of the products used in the processing of leather. The group did not aim, therefore, to achieve amazing income results, but to avoid the danger of losing a slice of the market already acquired, with the intention of serving customers who already bought from Italian companies products of medium-high range, adding to this also the products of low range, in order to continue to offer the end customer the full range. The main reason for fear was in fact that the customer, passing to the competition for products with a low content of know-how, could turn to the latter for other articles.

Specifically, no long and laborious investigations were conducted into the economic and cultural aspects of the market country; instead, the company has focused on the search for qualified and experienced Italian personnel.

Today it is a prestigious internationally recognized brand. The constant commitment to reliability and entrepreneurial competence, research, stylistic innovation, environmental policy, managerial and financial skills have allowed the Rino Mastrotto Group to establish itself in the leather tanning sector in Italy and abroad. With the management of its production divisions and subsidiaries, structured in a network system, Rino Mastrotto Group satisfies the complete tanning cycle, from the supply of selected raw materials, to the wide and specialized production of products that meet all market needs.

In fact, individual production divisions are expressly dedicated to creating the best leathers for producers and brands in the automotive, leather goods, furniture and footwear sectors. One of the priority objectives of Rino Mastrotto Group is therefore to achieve and maintain competitive positions that last over time while safeguarding the values and principles of the company's founder, which today are the heritage not only of the owners, but of all the people who work there.

Today, the latter is part of the group's fashion area, created to manage demanding and selected customers in the world of fashion and to guarantee them handcrafted processing for leather goods and footwear, despite the modern technology used.

The group, which in 2004 achieved a consolidated turnover of about 340 million euros, produces almost all the qualities of leather required by the domestic and foreign markets: ranging from leather for shoes of various qualities to leather for automotive interiors, to items for furniture and for the fashion industry or leather goods. Technological development, quality control and environmental protection are considered key factors in the company's strategy. In this regard, it is worth mentioning the research programme carried out in 2003 to study, develop and test a new vegetable tanning process for the production of articles for footwear and leather goods, to be proposed with calf and calf skins.

Thanks to the new process solutions, it is expected to be possible to create a new range of products for the tanning area of Veneto, in direct competition with productions located in other areas of Italy (particularly in Tuscany), while ensuring effective process control and a significant reduction in environmental impact.

The company, thanks to the high-quality level of its products, boasts among its customers famous brands of footwear, leather goods and furniture or car manufacturers.

Despite the crisis in the sector, Rino Mastrotto was able to substantially maintain its market share, decreasing its turnover by a modest percentage, almost essentially due to the fall in the value of the US dollar. Furthermore, it continued its production improvement activities thanks also to the synergies achieved with other associated and affiliated companies and to investments in buildings, technological systems and machinery, aimed at containing production costs and constantly updating technologies and means of production.

The company's mission is contained in 6 well-defined objectives:

- **the people:** employees and collaborators represent the heart of the company and for this reason the group tries to highlight its professionalism respecting the individuality through training, growth, and well-being. In addition, the group carries out initiatives in the field of corporate welfare in order to ensure the welfare of workers.

- **the made in Italy brand:** the group has always followed the philosophy of Rino Mastrotto, and the importance given to the Made in Italy brand is also demonstrated by the attention that the group pays to the storage of materials and projects used in the expansion of its products;

- **the product and relations with suppliers:** an example of the group's mentality and ideas regarding the product are concentrated in the new logistics centre, built in the city of Arzignano, where experience, professionalism, craftsmanship and efficiency are concentrated;

- **the strategic role of the territory:** the territory where a company is founded is fundamental for its future and for the generations that will be able to hand down a product of such high value;

- **the attention to the customer:** for the Arzignano group this is the main objective, and for this reason it has adopted a customer centric strategy that allows it to anticipate the needs that customers may express in the future;

- **the sustainability:** the company has always placed the theme of the environment at the centre of its development policies, in fact, it contributes to protecting and safeguarding it through initiatives that favour the reduction of the environmental impacts linked to the performance of the company's activities. In 2017, the Rino Mastrotto group adopted a sustainability policy with contents that highlight its commitment to the environment and ecosystems. The innovation process of the Arzignano district was applied in a first phase to the production of machines for product quality improvement and in a second phase to the automation of production processes. Lately, a considerable part of the investments destined to research aimed at containing the pollution of industrial processes, both in the chemical and mechanical fields, and at constant modernization. There is, in fact, concrete experimentation in environmental protection, which has also led some tanning companies to join forces for the development of a unique local environmental policy. One of the latest innovations aimed at protecting the environment is the one of the roller coating machines that allow to recover and not waste the chemical products. Today, ecological advantages have acquired the same importance as technical and economic factors: the use of less polluting products, advanced technologies, processes compatible with the environment and the purification of the goods used allow tanning companies to work peacefully in the area. The introduction of advanced technological solutions in the production cycles has also had significant effects on the improvement of product quality.

Rino Mastrotto is one of the largest industrial companies in the tannery sector for industrial use. The group's customer portfolio is particularly important in the automotive and luxury sectors. Already present with plants in Brazil and Sweden, it has grown both in number and in size, becoming one of the largest industrial realities in the sector.

The company from Veneto has planned a growth plan for 2017-2020, which also provides for an acceleration of the internationalization process, which aims to consolidate its leadership with a particular focus on the European, American and Asian markets.

A further increase is expected for the current year thanks to a policy of industrial investment both on the territory and at an international level, supported by the production platforms present in the various countries. The objective is to become a global multi-plant and multi-business supplier for international customers, with a competitive positioning that represents a unique position in the tanning sector worldwide.

5.3 The case of Rino Mastrotto Group and NB Renaissance Partners

The world tannery sector has an estimated turnover of 44-45 billion dollars, of which about 20 billion dollars originate from China and more than 5 billion dollars concern the Italian tannery. Over the next five years, an average growth rate of 6% per year is expected. The recent events of industrial development at a global level have amply demonstrated that the manufacturing sector is of crucial importance for the level and dynamics of overall income and, therefore, for the economic destiny of a country. For a long time, however, the prevailing opinion was that the fate of manufacturing production in an advanced economy was marked.

In particular, forecasts for the luxury world are +7% per year, +5% for the automotive sector and +4% for home furnishings.

In the coming years, the Rino Mastrotto group has chosen to invest in the luxury and fashion market and further diversify its activities. In this scenario, the Rino Mastrotto Group presents itself as an undisputed model company in the tanning sector also for its ability to combine the high-quality standard of its products with a rigorous environmental policy, based on sustainable and environmentally friendly industrial production.

In May 2017, Rino Mastrotto Group issued a minibond to support the 2017-2020 development plan: the group closed 2018 with approximately 320 million euros in revenues and 45 million EBITDA, after having closed 2017 with approximately

299 million euros in revenues, an EBITDA of 35.1 million and a net financial debt of 42.4 million.

In recent years the company has grown as the ambitions of the management have grown, which, while being fully aware of the radical change taking place in this historical period, from the economy to the tastes of people, believes that it has reached a level of experience in order define itself ready to meet these new challenges. This is despite the fact that the Italian tannery is penalized by a "country system" and must continuously face autonomously a market in which competitors can strengthen governments, business associations and the media that support them in a solid way.

Another interesting feature of the Rino Mastrotto Group that has made it attractive to potential investors is the growth recorded in the organization of the company itself.

In fact, in the last 5 years, the company has developed much more in managerial positions than in operational positions; this is natural if you analyze the particularly important objectives that the property has given itself.

In other words, Rino Mastrotto Group has the structure of a large enterprise. This element represents positive and negative aspects: if on the one hand an organization of this kind is preparatory to an important business growth in terms of turnover, on the other hand in a period of negative economic downturn similar to what we are experiencing now, the fact of having a solid structure is equivalent to being "heavy" and, this peculiarity, becomes a more negative aspect in addition to the economic cycle that shows a decline.

The characteristic described above were seen as an added value by the NB Renaissance Partners Fund, which believed in the growth objectives that the company's owners had set themselves. These objectives were more credible also in the light of the company's structure, which foreshadowed the desire to grow significantly even in a period when the economic outlook was not as good as it had been in previous years.

In order to find the financial partner to be included in the share capital, Rino Mastrotto Group surveyed the ground among the main Italian and foreign private equity funds. The dialogue was deepened with about 15 financial funds and then competed in 4 for control of the Group. Banca Imi's advisor was left with 4 offers: those of the private equity companies Alpha, Sun Capital, Nb Renaissance and Ardian.

During the summer months, Banca Imi's advisor started skimming the funds concerned and then made the final choice that resulted in.

The entry of a private equity company such as NB Renaissance Partners has the objective of bringing in capital to further implement the strategies undertaken by the leather company. The main choice is to turn the activity towards the fashion and fashion sector.

The Italian fashion sector is one of the few clusters in which our country can boast a solid tradition and a consolidated competitive advantage at international level[161]. It is a set of sectors, different both in terms of importance and weight, whose international leadership is demonstrated by the large quantities exported, the reputation of the brands, the presence of numerous fashion shows and exhibitions and the location in Italy of the most qualified productions of major foreign brands through relationships of supply, subcontracting, licensing and acquisitions.

NB Renaissance Partners has acquired the majority of Rino Mastrotto Group: an agreement that provides for the transfer to the financial fund of 70% of the capital. The remaining 30% remains in the hands of the Vicentine family.

In the following way, Rino Mastrotto, founder of the Rino Mastrotto Group, holds the position of Chairman, his son Matteo Mastrotto holds the position of managing director and his daughter, Barbara Mastrotto, remains in charge of the automotive division.

NB's reasons for choosing the Rino Mastrotto Group can be summed up in the investment strategy pursued over the years by the Arzignano tannery and because it represents an example of excellence of the Made in Italy brand in the world.

The importance of the link between the Italian territory and its own product is placed in strong evidence in the eyes of the consumer with the aim of obtaining a

[161] S. Testa, *La specificità della filiera italiana della moda* in M. Belfanti, F. Giusberti, *Storia d'Italia-Annali n. 19*, Einaudi, Collana Grandi Opere, 2003

set of advantages arising from the association of its product with the territory of origin.

NB Renaissance Partners was born in 2015 from the partnership between Neuberger Berman and Intesa Sanpaolo with the aim of managing private equity investments in Italian companies.

The entry of NB Renaissance Partners into the share capital of Rino Mastrotto Group will serve to implement the business plan lines presented by the Mastrotto family, which provides, among other things, a development of the joint-stock company towards further and deep diversification.

This project, shared by both players in the operation, is the basis of the collaboration between the Vicenza company and the fund. This operation represents a novelty in the panorama of Italian *private equity* and is the first time, in fact, that an institutional investor invests in the Italian tannery sector of the highest level and is a sign of attention to a reality that represents one of the business cards of the famous "Made in Italy" brand in the world.

The reasons behind the private operation are based on the convergence that gave rise to the agreement between the two operators that have profoundly different origins. On the one hand NB Renaissance Partners, which has the objective of making an investment with a medium-term time horizon and which has the opportunity to register a development that remunerates the capital initially invested. Clearly, these are the reasons that drive a private equity fund to conclude a transaction. On the part of the Rino Mastrotto Group, there is a consolidated intention to look for a financial partner interested in entering its capital in order to be able to develop the important growth objectives set. Precisely to achieve the latter, the company needed liquidity in such a way as to have capital available in the medium term without necessarily having to be remunerated by interest in the short term. Bank loans, in fact, are considered more dangerous especially in a period like this where the problem of the credit crunch is more accentuated.

In order to represent an attractive and credible investment for external lenders, Rino Mastrotto Group has undertaken a process of renewal of existing structures and, at the same time, has presented a business plan with a very ambitious project.

This is because the aim is not to bring in a simple partner, but a real partner who shares the same future vision of the Rino Mastrotto Group in the project presented.

Having said that, it is easier to understand how for Rino Mastrotto Group, the moment of the entry of NB Renaissance Partners does not represent a point of arrival but a real starting point that has the function of increasing the stimuli to realize the idea of business and development that, in previous years could only be presented as an ambitious dream, especially if you think that an institutional investor shares the idea and invests capital.

In addition to the above, the company has been able to take advantage of an indirect benefit which, of course, can be seen as a further motivation behind the operation: with the entry of an institutional investor into the share capital, the relationship with the credit institutions changes. The company takes on a different image towards the banks, being considered more reliable as if the new investor acted as a guarantor towards the credit institutions.

A point against the entry into the company's capital of a private equity fund can be represented, as already seen in the previous chapters, by the fact that this commitment is "fixed-term". In other words, entrepreneurs know that they can dispose of capital only for a limited period of time, often the investments do not last more than 5 years.

We have seen, in fact, that the search for a new financial partner was already in the intentions of the property at the time of the establishment of the new company and the banks have, precisely for this reason, granted the same credit lines opened with the previous company without the need for additional guarantees. Thanks to these loans, Rino Mastrotto Group was able to renovate the existing structures and launch new business lines such as Rino Mastrotto Group design. This preparation, of course, was seen in the perspective of the entry into the capital of a new partner. This figure was sought both among the most important families that make investments in unlisted companies and among private equity funds. The preferential path taken by the fund for the entry into the share capital of this company was favoured by the mutual knowledge and esteem that the people at the top of both companies could claim to have one towards the other.

NB Renaissance Partners was assisted by Legance (legal advisor), Bain & Company (commercial advisor), Deloitte (accounting and tax advisor), Gattai, Minoli, Agostinelli & Partners (tax advisor), Aecom (environmental advisor) and Fineurop Soditic (financial advisor). Essentia Advisory assisted NBRP as debt advisor in the structuring of the bank financing provided by a pool of Italian and international credit institutions.

The Mastrotto family was assisted - as legal advisor - by Chiomenti, while the commercial advisor is Roland Berger. Ernst & Young has worked in the accounting, legal and tax sectors and ERM represents the environmental advisor. Finally, Banca IMI acted as financial advisor to the Mastrotto family.

In the last three years the company has invested about 50 million euros, but to achieve its objectives, in a very competitive and quality-conscious sector, an even more ambitious project is needed.

The final outlet in the medium term could be the listing on the Stock Exchange, a passage that Rino Mastrotto has already experienced with Sicit, a chemical company in Chiampo, landed last May in Piazza Affari, thanks to the business combination with Spac SprintItaly.

Chapter 6

Conclusions

A *family business* is often a business with little capacity to finance and open up its capital to non-family members, a low innovative propensity and a hereditary nature of governance roles. These aspects and weaknesses are also related to the multiple needs of a complex asset such as the family one, made up of tangible and intangible components: the main requirement of the *family business* is to protect and manage capital from risks and uncertainties to ensure continuity and development. This confirms the considerable impact of the institutional and ownership structure of companies on access to finance and, above all, on the characteristics of bank debt itself, and continues to be considered the most important source of external financing for *family businesses*.

Banks can continue to play a leading role, as they have done so far, and the asset management services offered by intermediaries can represent the meeting point between the investment and diversification opportunities of private customers and the development and growth needs of small and medium-sized *family businesses*, but this no longer seems sufficient, especially in a more recent context. Institutional investment can be seen as a valid alternative to indebtedness, since it is considered by many to be able to compensate for the latter's weaknesses. A solid, diversified banking system able to adapt its offer to the needs of businesses and families is a strong point of our economic system, but it is not sufficient to accompany the Italian economy on a path of growth that is steadily higher than in previous years.

In several countries, the public sector has played an important role in favouring the development of intermediaries who invest in the capital of companies, in particular venture capital ones, since they act as stimulating elements, accelerating factors of market growth, and Italy has also moved in this direction by launching a number of national programmes for this purpose.

In this period, more than ever, *private equity* appears to be a valid alternative: the effects of the crisis that has hit the financial markets are manifesting themselves in the financial and real economy, bringing, among other consequences, the phenomenon of the credit crunch. This is demonstrated by the numerous and widespread entrepreneurial testimonies, which complain of the slow and inexorable reduction of credit lines by the banks, a more difficult use of existing credit lines and the impossibility of having new assignments of credit lines and financing.

The debate in the international literature is very lively in view of both the growing spread of the private equity phenomenon and the unambiguous conclusions reached regarding the role played by these investors and the effects produced on the target companies. There is no doubt that institutional investors make the capital market more liquid, improve information transparency, provide financial and non-financial capital, managerial and governance skills, but the fundamental question is whether they can have a positive impact on the operations of companies, or whether they can be considered a tool capable of improving and promoting their governance, competitiveness, internationalization, diversification of core business and growth in general.

Institutional sector representatives support the positive role played by PE: the creation of value for fund subscribers derives not only from the ability of fund managers to negotiate purchase and sale prices, but also from their ability to improve the various aspects of the business. As proof of this, the operators in the sector highlight the numerous successful deals, the high returns, the proven ability to fund raising, the dynamism of many venture-backed companies and the listing of some funds. The positive aspects described above mean that Italian entrepreneurs, especially *family businesses*, should use these financial instruments for their objectives.

Until a few years ago, the institutional investment market seemed to be underdeveloped both for reasons attributable to institutional investors and for reasons attributable to the entrepreneur-family owner. The reasons behind this were many: the hesitations about the condition of corporate control, the refusal to use debt leverage and the inability to conceive of management supported by external partners who may sometimes have different objectives and ideas from the entrepreneur or management. Moreover, the tendency not to share company information in a transparent way makes it more difficult for institutional investors such as private equity funds to analyse and evaluate characteristic companies such as *family businesses*.

Only recently, in fact, institutional investors have shown that they are expanding their range of reference by carefully considering also the family business market, initially considered riskier and less interesting in terms of economic convenience and which today seems to be subject to a slow, but continuous expansion.

In particular, the private equity industry is reluctant to invest in *family businesses* because their entry into the capital does not automatically determine a process of growth and development. In order for this to happen, in addition to the essential condition of the high professionalism required of them, it is necessary to find a company that is particularly attractive and ready to undertake constant growth processes.

Family owned companies are attractive for *private equity*, considering that they select companies where they perceive underperforming and where they are able to reverse this trend, whether the high concentration and proprietary control in continental European companies, the incentives of shareholders to monitor management and the private benefits of control influence the probability that the company is detected by a PE. Another aspect that reinforces the usefulness of studies and insights in the field of institutional investment in Italy is the existence of a potential market for the PE. The Italian market is in fact less mature, there are therefore interesting growth prospects, the lending banks have over time gained experience and more specific skills, there are specialized advisors who help operators of PE in the analysis and verification in the pre-acquisition phase and there are capital in search of good investments.

The biggest challenge facing the Italian market is to carry out operations within *family businesses*. In the past, FBs have favoured almost exclusively forms of concentration of power within the same family group, but for some time now they have been becoming aware of the importance of ownership structures and have realized that the development and growth of their business depends on and is linked to the ownership structure that characterises them. Until recently, in fact, there were many obstacles that Italian entrepreneurs had towards institutional investors: many owners and managers of companies have ignored or have not fully understood the phenomenon of *private equity* and / or have not evaluated well the potential offered by this type of investors.

In several cases, entrepreneurs have often focused only on criticism of the PE, including the main ones cited:

- debt, which is a cause for concern for entrepreneurs as seen as a limiting element of the operation;
- timing, as for the entrepreneur the time horizon is the entire life, which collides with the short-term investor, the high costs of the preparation of the operation, which are reversed on the company and where the entrepreneur has no decision-making power and a prior visibility.

However, entrepreneurs do not sometimes consider the many positive aspects that institutional investors, however, find as a result of the deal especially in *family businesses* or the fact that the financial resources and managerial skills brought by the PE favour: the improvement of the image of the company towards external subjects and the consolidation of the relationships with suppliers and customers; the acquisitions, allowing the company to pass from prey to hunter; a greater attention and/or the more formalized implementation of the management control, allowing the already present management team to acquire important professional skills on which they were lacking. In the end, what is not so obvious as it might seem, favour and allow the family owner-entrepreneur to remain in charge of his company, making it, moreover, grow professionally.

Criticism, therefore, risk triggering a wrong idea and generate an idiosyncrasy, an automatic aversion to this financial instrument. To prevent this from happening, in recent years, the various operators in the sector have been working in two directions: on the one hand, they have tried to make the positive aspects of institutional investment known and disseminated, and on the other, they have explored the issues considered critical by entrepreneurs, trying to propose new considerations and possible solutions. These promotional activities are carried out by specialists in the sector to allow the private equity market to grow and develop, being convinced that they operate in the interest of the Italian industrial system and help it out of the chronic under sizing of companies and the lack of competitiveness on the international front.

In particular, the main reasons why institutional investors, within the Italian FB, can prove useful are many: to bring FBs closer to the financial market; to support dimensional growth and facilitate the enlargement of markets, bringing the necessary resources and contributing to the definition and formation of various strategic alternatives; to plan the intergenerational path, facilitating generational turnover or the entry of new members; to orient management more towards the creation of value; to improve or change governance systems often considered one of the main brakes on the development of FBs.

In the current Italian context, on the one hand, companies, especially those of a family nature, are beginning to appreciate in a positive way the contribution of resources, financial and otherwise, from institutional investors and are willing to loosen the forms of power that have characterized them for a long time. In particular, the opening up of risk capital to an institutional investor seems to generate greater value, especially in *family businesses* where the business model, even if on the whole efficient, is not fully exploited by the existing ownership structure.

In these cases, the *private equity* helps to achieve unspoken value by fostering processes of growth, managerialization and improving corporate governance.

In particular, it is possible to make two brief considerations that bring out the judgment and the global vision that Italian entrepreneurs have of the phenomenon of "institutional investment":

1) entrepreneurs are not aware of the real possibilities offered by the private equity, they do not know them as possible tools for managing the generational changeover or growth and alternative financing in general;
2) often the use of the PE represents the last solution available to the FB, an extreme remedy to the inability or impossibility of managing the succession process in the context of family company structures and, consequently, the poor planning of this share transfer from family to institutional investor can play to the disadvantage of the old shareholders.

This shows that the role and potential of *private equity* has not yet been fully understood, as there is often insufficient knowledge, skills, culture and financial education.

In most cases, when entrepreneurs and family owners decide to open up to the PEs, they do not have sufficient managerial or psychological preparation to face this epoch-making step. They are not ready, and often not even available, to adapt to the new status of co-owner or to share the decisions and entrepreneurial activity in the *family business* that were previously exclusively theirs and to see their powers resized. The psychological aspect, which is not usually considered a critical element in deals, is a crucial issue for the success of the industrial and financial project: human capital is in fact one of the three factors that make up the company, in addition to financial capital and productive capital, and as such must not be neglected, but must instead be considered in the choices and strategies before and after deal.

In the light of the analysis carried out so far, it can be concluded that the crisis that has hit our country in recent years may represent an extraordinary opportunity, an opportunity to redefine the business structures and the way of doing business of a system that is structurally in need of renewal. Within this scenario, the paths to be taken are massive but the choice of companies considered in this work are two: internationalization and diversification.

The Pasubio Tannery, belonging to the Pretto family, has embarked on a so-called intelligent internationalization path, that is to say an internationalization developed through a well-planned strategy, which takes into consideration all the aspects and critical elements affected by this change. Such processes cannot be improvised or carried out on an occasional basis; in all these cases, the result is always a poor exploitation of the opportunities offered by international markets. From this point of view, the analysis carried out on the Pasubio case is certainly emblematic and perfectly reflects this intent, being perfectly in line with what is defined in the literature. If well prepared, internationalization is undoubtedly a strategy that pays off and the resumption of the growth of the turnover of Pasubio that in the 5 years preceding the private operation had suffered a decrease in turnover is proof of this. But internationalization is not only a profitable strategy from an economic point of view, it is also a driving force for non-economic aspects such as the development of knowledge and skills, the development of new relationships and the enhancement of its brands and products.

On the other hand, Rino Mastrotto Group has preferred to choose the instrument of diversification: implementing a strategy of this kind is inspired by objectives such as the need on the part of the company that makes acquisitions, to support companies that have a strong liquidity, alongside others that instead, although presenting a good potential, do not have adequate liquid resources to be able to make the necessary investments and try to compensate for the cyclical performance of a sector through the presence of business with the opposite cyclical performance.

In the case of the Rino Mastrotto Group, the choice of the diversification process leads the company to enter new areas of activity or business with consequent great changes in the organizational, administrative and management structure of the company. For Rino Mastrotto, diversifying means expanding the range of action of the *family business*: a range that expands towards new sectors to increase more and more both with the tanneries in the district of Arzignano and to compete with the increasingly aggressive Chinese competitors on the world market.

Implications

The study has some practical implications for both private equity operators and entrepreneurs running family businesses. For private equity operators, the objective of the operation must not only bring liquidity to the company's coffers, but must also contribute to creating overall value, which, in my opinion, means generating wealth for the entire economic and entrepreneurial fabric of the tanning district. It follows that private operators must pay attention and deepen especially the development project and with growth prospects both in terms of size and income. The aim is to select the 'winning' entrepreneurial initiatives that will allow family businesses to continue their industrial path for many years. On the family business side, my thesis can be used to improve business performance, professionalize management and organization, evolve systems for planning and control and monitoring business results, improve the image of the family business vis-à-vis banks and the financial market, have greater ability to attract capable and experienced management.

Limitations

The limitations encountered in carrying out this thesis consist, in the case of Psubio, in the closure of the company in providing more detailed information, sector analyses carried out for its activities in order to expand the research conducted interviews with management that would have helped me to better understand the reasons for using both *private equity* and the choice of internationalization for the future of the company.

The limitations encountered in the in-depth study of the Mastrotto case, on the other hand, were due to the fact that the choice of the fund took place about a month ago.

In this case, unlike what happened with the company Pasubio, it is not possible to verify the financial, corporate and organizational consequences that will certainly be seen next year.

Avenues for future research

The aim of this research is primarily concentrated to help *family businesses* that want to abandon their own perspective on themselves and continue their business looking for and finding in private equity funds a solid tool, fast, flexible to their needs and able to overcome periods of internal financial crisis. Looking to the future, further research and studies are needed to understand how, and in which financial and managerial-organizational context it is very useful to facilitate the meeting between private equity investor and entrepreneur.

This study can be a starting point for all companies in the tanning sector, especially in the district of Arzignano that want to take the road of internationalization and diversification of their core business and do not have the financial, organizational and network to achieve these goals. Finally, this research could represent an effective tool for small *family businesses* in the Vicenza district that would like to broaden their horizons but do not have the tools to do so.

Appendix

The regulatory evolution of private equity: an international comparison.

Overall: The regulatory scenario in Italy. A comparison of *private equity*: from Europe to the Unites States. The AIFM directive and the EuVECA Regulation. The development of the regulatory framework for risk capital in Asia

The regulatory scenario in Italy

In Italy, the official start-up year for *private equity* and *venture capital* activities dates back to 1986 with the creation of AIFI, the Italian Association of Private Equity and Venture Capital, created thanks to a number of private and bank-based financial institutions that decided to set up this association with the aim of establishing and developing a common market for risk capital. Since then, venture capital investors have been operating and the relevant regulations have also evolved.

The most important interventions were the following[162]:

- 1987: the resolution of the ICRC (Interministerial Committee for Credit and Savings);
- 1993: the enactment of the Consolidated Law on Banking and Credit by means of Legislative Decree 385/93;
- 1993: the enactment of Law 344/93, which established closed-end investment funds;
- 1998: the issue of the Consolidated Law on Finance (Testo Unico della Finanza) the Legislative Decree 58/98;
- 1999: the issue of the Treasure Decree No. 288;
- 1999: the issuance of the Bank of Italy's measure of September 1999;
- 2003: the issue of Treasury Decree No 47 of January 2003;
- 2005: the issue of the Bank of Italy measure;
- 2010: the reform of Title V of the Consolidated Banking Act (Testo Unico Bancario);

[162] F. Sottrici, *Venticinque anni di Private equity in Italia: evoluzione e caratteristiche dall'origine ai giorni nostri*, LIUC paper numero 262, febbraio 2013

- 2011: the Directive on Alternative Investment Fund Managers (Gestori di Fondi di Investimento Alternativi – AIFMD);
- 2012: the Development Decree no. 83 of 22 June 2012, later converted into Decree no. 134 of 7 July 2012;
- 2012: the Development Decree Bis of 18 October 2012, converted into Decree number 221 of 17 December 2012;
- 2015 the transposition of the EU Directive on Alternative Investment Fund Managers (AIFMD) and the implementation of the EuVECA Regulation on European Venture Capital Funds.

Until 1986, the activity of investment in risk capital in Italy for unlisted industrial companies was closed to credit companies and studies. Since 1987, however, thanks to the resolution of the CICR and the relative circular of the Bank of Italy of the following month, these two categories were also allowed to operate in the risk market through the financial brokerage companies of their issuance, the SIF *(Società di Intermediazione Finanziaria* - Financial Intermediation Company), whose scope of action is related to the assumption of bonds, shares or similar securities of a temporary nature in order to be able to participate, albeit in a minority, in risk capital.

The first major step in recognising the functions performed by credit institutions was the issuing of merchant banks, that is, a set of financing and advisory activities carried out by financial operators in direct support of business activities. This was the starting scenario unchanged until 1993 when the Consolidated Law (*Testo Unico* - TU) on banking and credit was issued in September of that year, which brought about the principle of temporal and functional despecialization, proposing the organizational model of the "universal" bank, revolutionising the regulatory apparatus inherent in this segment.

In this way, the activity of investment in participations in non-financial companies carried out by SIF of the banking sector was included among the disciplines of the TU in banking and credit matters and introduced a distinction between banks and banking groups, banks and enabling groups and specialized banks, setting limits. Another new element was Law no. 344 of August 1993 on closed-end real estate investment funds under Italian law, which expanded the international financial landscape from the point of view of risk capital operators by equipping it with the most widespread international instrument.

The law instituted closed-end funds and entailed limits linked above all to the presence of constraints and prohibitions that negatively conditioned the operation of the instrument. Since 1997, the regulations have undergone various changes introduced in the process of fiscal and structural revision of the Italian financial market, which have led to the elimination of some major obstacles that prevented our country from confronting the main European countries but also international on an equal footing. Very important in this sense was the issue of the Consolidated Law on Finance (*Testo Unico della Finanza*) introduced by Legislative Decree no. 58 of February 1998, which reformed all the regulations relating to financial intermediation, introducing the figure of the single manager of savings with the structure of the asset management companies, SGR. In April 2005, the Bank of Italy issued the Regulation on the collective management of savings, and the Bank of Italy and the Ministry of the Treasury subsequently issued regulatory provisions that reduced the framework for the establishment and operation of closed-end funds, giving them greater flexibility and consistency with the international context.
In the first half of the 1980s, the first forerunners in the world of risk capital were private operators who began to transfer their capital or that raised by shareholders to the system of small and medium enterprises. The banking sector joined only subsequently, first with specialized companies, then through internal divisions of the banks themselves. Since the first half of the Nineties, a growing number of advisors of international closed-end funds already present in the territory, but previously in small size, and closed-end funds under Italian law have begun to operate. Currently, it is precisely these last two categories that are on the increase.
In 2012, two decrees were issued, the Development Decree and the Development Decree Bis, mainly with the aim of implementing urgent measures for the growth of the country. However, they also dealt with the establishment of a form of self-financing for unlisted companies, namely the minibonds: credit instruments that a company issues as a guarantee to obtain money from specialized operators[163].
In particular, article 32 of the Development Decree of 22 June 2012, converted into decree number 134 on 7 August of the same year, allows small and medium-sized unlisted companies to obtain investment capital, also in relation to certain characteristics of them, thanks to the issuance of both short and long-term debt instruments. All of this has limits, first and foremost, the issue must be accompanied

[163] PwC, *L'impatto economico del Private Equity e del Venture Capital in Italia*, 2015.

by a sponsor, the latest financial statements must be audited by experts and the securities must be placed only with qualified investors who are neither directly nor indirectly shareholders of the issuing company. It also intervened from a fiscal point of view, extending the deductibility of interest expense in favour of issuers and investors of Minibonds on the basis of the rules for listed companies, extended the deductibility of issuance costs and the exemption of withholding tax on proceeds from securities traded on regulated markets.

The Bis Development Decree has introduced new, renewed regulations on Minibonds in order to increase their diffusion thanks to the increase in the number of subjects admitted to subscription and thanks to new incentives, always on a fiscal level, for the subscribers themselves. With the same objective of encouraging investments in risk capital, it has provided for a strengthening of ACE, Aid to Economic Growth (*Aiuto alla Crescita Economica*). This basically provides for two innovations: the first concerns the 40% increase in the equity capital compared to that already existing at the end of the previous year, therefore the increase operates for the tax period in which admission to regulated markets takes place; the second provides that from 31 December 2014, the part of the return that exceeds the total net declared can be increased by the amount deductible from income in the following period but also can be used as a tax credit to reduce IRAP. To complete the regulatory framework, reference should be made to the most recent reform of Title V of the Consolidated Banking Act implemented in 2010, the European Directive on Alternative Investment Fund Managers (AIFMD) of July 2011 and the EuVECA Regulation on venture capital funds, details of which are given in the previous paragraph.

A comparison of *private equity*: from Europe to the Unites States

After the years of great international expansion, the famous Golden Age of *private equity*, which runs from 2003 to 2007, favoured by low-cost financial liquidity and a very attractive regulatory framework, has led to a slowdown in investment activity across Europe and the United States[164]. All this has hindered the implementation of the largest operations, but not only that, there have also been consequences in terms

[164] Available on https://www.privateequityinternational.com/pe-basks-golden-age-returns-report/

of the volume of capital raised, which has seen a major reduction between 2009 and 2011.
The various phenomena that have affected the financial markets have shown how the risks that materialise in one sector of the market, can be transmitted to the entire financial system with major repercussions for the stability of the market itself. This has meant that authorities and governments have to act quickly to restore confidence, introduce support measures, especially in banking systems, and strengthen market transparency as a means of protecting investors' interests.
Overall, the regulatory framework was completely unsuitable and inadequate for the prevention and management of systematic crises. This is the reason for the plans to reform the institutional structure of financial supervision undertaken in Europe and the United States and the specific regulations adopted for certain instruments whose provisions were not harmonised or incomplete.
The Alternative Investment Fund Managers Directive (AIFMD) and the European Venture Capital Funds Regulation (EuVECA) in Europe and the US Dodd Frank Act reflect this approach and provide the regulatory frameworks that have a direct impact on the management of *private equity* and *venture capital* funds.
Another element of the tightening of the regulatory framework is due to the new EU rules on the investment policies of large institutional investors. Solvency II also exists for insurance, the IORP Directive (Institutions for Occupational Retirement Provision) for pension funds and the CRD IV (Capital Requirement Directive) for banks. Despite the fact that in Europe the capital of banks, pension funds and funds of funds together contributed to a large part of the funding for 2016, the weight of these investors decreased compared to the pre-crisis period.
Many institutional investors, who in the past have contributed in large part to the collection of the sector at international level, want to rationalize their commitments, through the decision to subscribe to higher shares of a smaller number of funds. An analysis of the international picture shows that new balances are being created, which are leading to the emergence of a tendency towards disintermediation of management.
In the United States, a key date was July 2010, when the federal law, the Dodd-Frank Wall Street Reform and the Consumer Protection Act (or Dodd-Frank Act), was approved, whose aim was to protect the rights of consumers and investors and to improve the transparency and accountability of financial market operators. This

Directive provides for registration and compliance requirements for advisors of private equity funds. As part of the measure, the Volker Rule introduced provisions to fully limit US banks' exposure to certain assets that have been deemed to have an impact on systematic risks, including private equity funds. In detail, this directive has required banking institutions, whose deposits are guaranteed by the FED, to limit their exposure to alternative investments to 3% of their Tier 1 capital. It is also called core capital or primary quality capital because it is the hard core of the capital of every bank in the world, they contribute to forming it the paid-up capital (reserves and retained earnings), and finally to limit the participation in a group of proven equity to 3%. These provisions also apply to European banks with a subsidiary in the United States. The framework provides for transparency obligations towards the US supervisory authority on those profiles whose monitoring is essential to prevent possible risks. Private equity fund managers with assets of at least $150 million in the US are subject to registration requirements. Sub-threshold entities and venture capital funds are exempt from registration and related obligations. On the one hand, the reform has made it possible to strengthen transparency and compliance safeguards to protect the interests of investors and, on the other hand, it has created new operational constraints and increased management costs.

The AIFM directive and the EuVECA Regulation

In order to create a harmonised framework on *private equity*, the European authorities considered it necessary to intervene by introducing the AIFM Directive[165], which is concerned with regulating the management of alternative funds.

AIFM contains rules on the authorization, operation and transparency of managers (GEFIA) that market and manage alternative investment funds (FIA) in the Union and also lays the foundations for a common approach to protect investors in AIFs, as the marketing of AIFs is aimed at professional investors, namely investors who are considered as professional clients or can be treated as professional clients within

[165] It sets out a series of measures to promote a broader integration of the asset management market, by harmonising the discipline applied to legal forms and alternative investment strategies.

the meaning of Annex II of Directive 2004/39/EC, known as the MiFID Directive[166].

The AIFM rules are detailed by the implementing measures contained in the Commission Delegated Regulation no. 231 of December 2012, which was published in the Official Journal of the European Union of 22 March 2013.

An exemption threshold has been identified for certain categories of operators for whom a lower systematic risk is associated. These are those entities that manage portfolios of funds whose assets amount to less than €100 million or €500 million, if the funds under management do not use leverage and do not provide redemption rights exercisable for a period of 5 years from the date of initial investment (lock-in).

The limit is therefore set at a higher level since those who do not resort to leverage are considered less risky for financial stability. It has been established that according to the AIFMD rules, an alternative fund is considered to have "substantial" recourse to leverage if its level of indebtedness is three times higher than its Net Asset Value. Such fund will be subject to enhanced transparency and reporting requirements.

Sub-threshold managers, that are those managing funds below the thresholds indicated, are required to register with the competent authorities and to inform the authorities about the investment strategies, main instruments and exports of the funds they manage.

The Directive provides for certain capital and authorization requirements for operators:

- managers must have a minimum initial capital of €125,000 if it is an external manager or €300,000 if it is internal. It can be defined as external if the fund is managed by a separate legal entity, but entire if it is considered a managing entity according to the Directive;
- they must strengthen their own capital, either by having adequate additional funds or by taking out insurance to cover potential risks arising from professional negligence. The minimum coverage must be equal to an aggregate level, at least 0.9% of the total amount under management.

[166] Consob, "*La Direttiva Mifid*: *Guida per il Consumatore"*, Marzo 2008

Analyzing instead the Directive from the point of view of organizational obligations, the manager must:

- establish a risk management function that has a functional and hierarchical separation with respect to operational roles;
- identify a risk management policy to be updated periodically to identify, measure and manage any risks connected with the management of the fund;
- make use of an external evaluation function or, if internal, independent of portfolio management, which avoids any potential risks;
- identify a depositary who, in addition to the activity relating to the post-closure phase of the transactions carried out, has the right to exercise ex ante monitoring when deemed necessary by the depositor;
- must inform the authorities responsible for financial supervision whenever the voting rights of a non-listed company are exceeded, reached or decreased below the control threshold of 10%-20%-30%-50%-75%. What is required of the manager is to communicate the acquisition of control by the fund to the non-listed company, to the shareholders whose identities and addresses are available to the manager or can be made available with the non-listed company and finally to the competent authorities of the home Member State.

In the event that the manager acquires the ownership of 50% or more of the voting rights of a non-listed company, he will have to comply with certain additional disclosure requirements. Not only must the manager also ensure that on the company's board of directors he communicates the information to the employees' representatives or, in their absence, to the employees themselves. It will then have to inform investors and the supervisory authority in relation to acquisition financing.

The Directive also provides for obligations to refrain from certain shares for managers who have acquired control of a non-listed company. These obligations have been identified to mitigate risks related to the phenomenon of asset stripping, to which companies could be exposed in the two years following the acquisition. Among the transactions in the prohibition are:

- distribution, including payment of dividends and interest;
- reduction of capital;
- redemption of shares;

– purchase of own shares by companies or by those acting on their behalf.

Managers must take care to prevent such transactions and must not vote in favour of them on behalf of the fund in the investee company. Finally, provisions have been introduced on managers' remuneration policies. The categories of relevant persons to whom the different provisions apply include those who take on the risk associated with the management activity, that is to say the senior management, those involved in the management of holdings and in the control functions.

This is the principle of proportionality, according to which managers are required to carry out the requirements in relation to the size, internal organisation and nature of the activities managed. At least half of the variable remuneration must be paid as units in the fund and at least 40% of it must be deferred over a period of three to five years. Payment of the variable component shall only be made if it is sustainable on the basis of the overall financial situation of the fund manager and justified by the achievement of positive performance. Compliance with all the requirements of the Directive means that managers receive a passport for the management and marketing of alternative funds to professional investors.

This means that, thanks to the authorisation of the competent authority of the Member State, alternative funds from other Member States can be managed and marketed to investors from a different State from the original one. AIFMD also regulates the management of non-European funds from open-ended European managers and their marketing within the Union but also extends to the management and marketing within the European Community of European and non-European funds by non-European managers.

These forecasts have been fully effective since the end of 2015. Initially, the various operators were reluctant to introduce the regulatory framework due to the high costs, after the various adjustments that have reduced the constraints on the operation of managers, all the benefits that flow from it have emerged more clearly. The European market is more attractive to investors, the harmonization of authorization procedures and standardized documentation facilitates the connection between the various investors who previously encountered the difficulty of being faced with different rules in relation to the jurisprudence of the country with which it dealt. Fixed costs are high, however, especially in relation to the obligations introduced, and this could benefit managers who manage larger assets. A number

of Community guidelines have also been drawn up on the harmonisation of the various tax systems.
In addition to the AIFMD Directive, the European Commission also proposed a specific regulatory framework for venture capital funds. In order to prevent them from being penalised as they can contribute to the risk capital needs of small and medium-sized enterprises, the European and Council Regulation for venture capital funds, the EuVECA Regulation published in the Official Journal of the European Union on 25 April 2013, has been introduced. The aim is to create a single market for venture capital funds by issuing a European passport based on simpler rules than the AIFMD. The aim is to overcome the regulatory fragmentation that makes it difficult for specialized funds to raise resources from institutional investors in different countries. The regime is optional, so those who wish to can register funds that meet the requirements as EuVECA funds and market them in Europe.

The development of the regulatory framework for risk capital in Asia

China has also not been immune from *private equity* and Chinese insurance companies are a very important source of risk capital. The *Chinese Insurance Regulatory Commission* (CIRC) has recently taken encouraging steps towards creating a regulatory framework that allows local insurance companies to invest in offshore funds and RMB funds, a particular fund set up by the Chinese government called Renminbi. The legal regime under which such investments will be allowed is work in progress, as there are rules that differ between Offshore and Onshore rules.
In June 2013, the *China Securities Regulatory Commission* (CSRC), the regulator of the securities sector in China, the primary regulatory body for the domestic private equity industry in China, drew up a new set of rules to regulate private investment funds, including private equity funds, which are currently being revised by the State Council of China. At the same time, the CRSC authorised the *Asset Management Association of China* (AMAC), a national self-regulatory organisation for the fund industry, to administer a new regime requiring the registration of China's national private equity fund managers and also a part of the RMB funds[167].

[167] Preqin Special Report, *Asian Private Equity*, settembre 2015

This new regime came into force in February 2014 and represents a significant change. This regime only applies to domestic funds while foreign managers and foreign funds are currently not required to register with the AMAC.
The main changes concern:

- domestic managers (including managers, with foreign investments) must register and apply for membership with the AMAC;
- managers must update their documents on a quarterly and annual basis, and must promptly report any changes to previously recorded information;
- the AMAC has indicated that it does not intend to carry out a substantial verification of the material sent by the managers. Some basic information will also be made public on the website;
- the registration deadline for managers at AMAC is April 30, 2014.
- no deadline has been set for RMB funds.

These are the main innovations introduced by the Chinese government for better regulation of venture capital funds. Investors investing in Asia must also be aware of the various consequences that the local tax system has and how it can affect the overall returns on assets, must be able to handle situations actively through proper adherence to disclosure. For example, many Asian jurisdictions impose withholding taxes on dividends paid by resident companies, and taxes on capital gains from disposals of shares in resident companies by non-resident shareholders. These taxes often represent losses. Of course, the rules in each country are different and some countries, such as Singapore, have introduced tax breaks that have led to increased investment in their markets. A very high risk is the risk of legal double taxation, that is the possibility that an income, pertaining to a subject, is taxed twice, both in the resident country and in the foreign country. Some Asian countries have signed double taxation agreements that also protect venture capital funds. Finally, in China, Communist Party policies have been introduced that focus on investments in Internet companies. The government is trying to focus on innovation and the nascent entrepreneurship of new start-ups in order to give greater prestige to its economy. Furthermore, the authority has constituted a fund with a value of 10 billion dollars for the promotion and diffusion of innovative activities in some Chinese cities (16 in particular). The fund will be used for the development of the technology sector. Finally, a lot of investment is being made in start-ups, including the creation of new funds called "angel funds", with a technological imprint.

In conclusion, the Chinese government wants to focus heavily on risk capital and tries to facilitate investors as much as possible, without forgetting, however, that there are strict rules for implementation and investment in the Asian market.

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Executive Summary

The term *private equity* refers to the activity of investing in the risk capital of unlisted companies. Private equity funds are closed-end securities funds that raise capital from individuals and institutional investors, such as banks, foundations, insurance companies and pension funds, to invest in unlisted companies with high potential growth. The mission of *private equity* is to support the development of companies in critical periods of their life cycle and then take advantage of it through the listing on the stock exchange. The investments of the funds can also be presented as negotiated transactions, subject to processes of evaluation, structuring and pricing outside the stock market and to the reference to quoted prices where, with this last term, we refer to the classic meeting between supply and demand that takes place in the listing markets and that allows all operators involved to be able, in a very short time, to evaluate a company.

Investments in the private equity sector are characterized by:

- the sharing of entrepreneurial risk by the investor;
- the time horizon of the investment between three and seven years;
- the active involvement of the investor in the management and development of the investee company;
- the high attention paid to the strategic and industrial characteristics of the investee company rather than to the exclusively financial type.

The birth of PE operators has allowed companies to benefit from new capital to be allocated to development and to avoid the problems of credit rationing due to uncertainty and lack of information that characterize the organizations in which the funds themselves invest.

In 1986, an association called AIFI was set up, initially made up of nine private financial and banking companies that joined forces to create this new institution. With the increase in activity and the strong expansion in the private sector in 1994, the name was changed to *Associazione Italiana delle Finanziarie di Investimento* (Italian Association of Institutional Investors in Risk Capital) to include also closed-end securities funds that were born in 1993.

Subsequently, technical commissions were created within AIFI with the aim of creating working groups with a focus on specific topics and activities in order to be

able to deal more efficiently with any specific problems, critical issues and relevant issues.
AIFI carries out various activities, starting with institutional activities, thanks to an intense lobbying activity in order to carry out initiatives aimed at creating an advantageous environment for *private equity* and *venture capital*.
The presence of a private equity fund in the capital of a company helps in this sense because it pushes companies to have commercial and financial contacts even outside their industrial district and, often, Italy, is a strong motivation to achieve maximum development, encouraging greater propensity to support the risk of undertaking a process of international growth in the face of potential and high future returns.
The presence of an institutional investor pushes the company to adopt clear and transparent rules of governance, expressly in the statute. The system of governance rules aims to regulate the stability of the corporate structure and the incentive of the entrepreneurial partner and the management, the governance of the company and the corporate information, the divestment by the investor partner.
Private equity has the function of pushing the entrepreneur to open himself up to the outside world, to favour the constitution of the board of directors with members who do not strictly belong to the family, in order to obtain greater autonomy in the management of the company. Private equity operators create value because they are able to favour a more efficient supervision and monitoring activity, bringing in a series of government rules whose main objective is to unite the interests of the different actors involved in the company so that all contribute to its creation of value.
Private equity also contributes to the relaunch of the system both in terms of innovation and technology transfer: with the aim of increasing competitiveness, economic and social development is very important to support applied research and technology transfer processes to businesses. *Private equity* is a very important tool for restoring companies in crisis, giving managerial and economic support to the restructuring processes necessary for the lack of generational turnover, wrong strategic choices and aggressive competition.
The processes of economic globalization, the international opening of markets and the advent of new process and product technologies have meant that, today, efficient and effective management and greater awareness and adaptation to the

changing environment represent the watershed between the winning *family businesses* and those, instead, destined to leave the market.
To create value, in the phases of generational turnover that characterize every business reality, the people who, respectively, take over and leave the company, are often in different phases of their life cycle with regard to success and satisfaction. In particular, there can be large differences between the person leaving the company and the person taking over in terms of values and lifestyles that can affect both the transfer of the business and the future organisation. In this perspective, the problem of choosing a successor appears to be crucial.
Competitive advantage, understood as the company's ability to occupy a favourable position in the market in which it operates, is not, in fact, a stable factor over time, so once achieved it does not remain so. This position of superiority can, therefore, be threatened by changes in the market that can change the factors of success and by the action of competitors.
Over the years, the progressive emergence of the global dimension of the market has forced *family businesses* to adopt a vision that is also necessarily global. The idea was therefore developed that an internationalization strategy would be adequate to compete in the current context. This strategy, in fact, allows the acquisition of new resources, the development of one's own wealth of knowledge and the strengthening of one's own reputation. This has led to the development of so-called make together collaborations, which include joint ventures, commercial partnerships and business networks, with the aim of sharing knowledge and synergistic skills and reducing transaction costs associated with entry into a new market. In the landscape thus outlined, small and medium-sized *family businesses* have specific strengths and weaknesses and many of the traditional problems they face are worsening in a globalized system and in an environment dominated by technology. Some of the traditional problems are:

- lack of funding;
- difficulties in exploiting technology;
- limited managerial skills;
- poor productivity;
- regulatory constraints;
- generational changes;

It is therefore essential for this type of company to improve their ability to collect information, enhance their technological support and, above all, increase their managerial skills. The vitality of entrepreneurial activity is, in fact, fundamental for the development of *family businesses.* The generational changeover is a particularly delicate moment in the life of a company because it inevitably involves its economic and financial aspects as well.

The financial aspect is worthy of importance, especially with reference to the relationships that the company has had, during its life, with the banks of reference. Bank branches have systematically been a point of reference for *family businesses*, supporting their development and growth by providing them with means and advice, which in most cases has assumed a personal and confidential character. In relation to the changes underway, this relationship may also undergo changes and assume a more formal character; however, this should be done gradually and with the necessary preparation. This is also because in our country there is not yet an evolved tradition of merchant banking, namely there are few financial institutions that play an effective role of participation in the financial management of the company without short-term speculative objectives.

The changed market conditions are, in fact, underlining the inability of the Italian productive system to compete adequately with other systems, given the low propensity to innovation, the inadequacy of the productive capacity and the difficulty to compete in markets other than the national one. These difficulties are connected, above all, to the question of access to information, to the complexity and not complete homogeneity of the regulations and to the onerousness of the administrative procedures.

In *family businesses*, one of the most widespread phenomena is the inadequacy of risk capital with respect to the real economic and business needs, which causes financial instability as well as lack of credibility towards business interlocutors such as banks and other financial subjects. This pathology is manifested and is evident through the reading of the balance sheet items as well as by comparing economic and asset values and evaluating their trend from one year to the next, through analysis by correlation indexes or other monitoring tools.

From a strictly financial point of view, there are problems that can generate tensions within the company, such as:

- "confusion" between the personal finance of the entrepreneur and that of the company
- constant reliance on credit institutions
- permanent lack of liquidity (time lag in the collection of credit and the payment of debt or absence of a univocal and constant behavioural approach in the management of credit and debt)
- structural and organizational oversizing with respect to the ability to generate business profitability
- practice of commercial policies aligned with respect to the market, but not with respect to the need to cover fixed costs (an increase in prices would result in an exit from the market)
- management of stocks of warehouse dispersive and not related to the demands coming from the market outlet.

Private equity funds are therefore assuming an increasing weight on the national and international economic scene for their function of intervention in support of companies of all sizes in order to develop their business. Today, *private equity* is an important opportunity for *family businesses* that, through these funds, can find the liquidity they need, liquidity that they can use in the medium term without necessarily having to remunerate capital in the short term.

An entrepreneurial family, in fact, may find itself with limited resources and consequently must find the capital necessary to support its growth. When we talk about the entrepreneurial family, we refer to a group of companies with substantially different characteristics, especially in terms of structure, size and governance models. A common feature is the family's control over the management: the partners who control these companies - the family members - are encouraged to monitor the activities of the management because they are strongly linked to the company.

This last aspect is certainly a great advantage because the entrepreneurial family - especially in times of crisis - will try to ensure its business continuity. In this way, the collaboration between the entrepreneurial partner and *private equity* is crucial to allow the meeting between the operational capabilities of the former and the financial capabilities of the latter. Together, the two parties will be able to better define the financial and operational strategy of the company. The entrepreneurial partner is the one who had the entrepreneurial idea, the one who shaped the company according to his beliefs by defining the internal culture. The investor partner cannot allow his direct exit otherwise he would risk annihilating the productivity of the company, so it can be said that the first investment is made in the partner entrepreneur to ensure that he has an active role throughout the life of the investment (or at least, if the entrepreneur decides to alienate his participation, until the PE has managed to create the right culture to maintain a good level of productivity).

With the introduction of *private equity*, the board of directors assumes a fundamental role as an organ of the company and not of the family. The role of the board of directors of a *family business* is to define the strategy of the business, to monitor the work of the management and to select key figures such as managing directors and managers. The inclusion of numerous rules for the corporate governance of the company therefore entails a more structured organization. This aspect is not only fundamental for productivity, but also helps to provide the market and banks with a better-quality flow of information, which translates into lower financing costs. All this appears to be very advantageous for *family businesses* and the reason for this is the transparency of the business vis-à-vis third parties.

Finally, the funds can be a pole of attraction for a better human capital with the necessary skills to bring the company from a family management to a managerial management.

In conclusion, the benefits of private equity investments are very important and, in the critical phase of generational turnover, represent an opportunity for growth, development and improvement of the company's capital.

In 2018, moreover, the amount invested in the Italian *private equity* and *venture capital* market reached its highest value ever, thanks to a number of significant transactions that took place not only in the buy-out segment, but also in the infrastructure segment, which in recent years has played an increasingly important role.

Private equity, as a financing system used by *family businesses,* not only supports these companies through the contribution of capital, but its action has a direct impact on the real economy of the countries in which it operates, contributing to the generation of new jobs and to the growth in revenues of the companies acquired, in terms of productivity, investments and EBITDA.

In recent years, in the tanning district of Arzignano, there have been reasons why the families of the local business have had to face various problems such as the need to invest a high amount of money, not only related to investment in real estate, but also related to the purchase of inventories, of the warehouse stock, the opportunity to invest in new markets and emerging, the difficulty in obtaining permits for leather processing, the need to diversify its core business.

For these reasons, two tanneries such as Pasubio and Rino Mastrotto have implemented two different policies to address the problems listed above.

The international strategy is, in the case of the Pasubio Tannery, a requirement both for the expansion of the outlet markets and for the opportunities for production relocation. The latter respond to a process of entry and development in foreign markets in which it is intended to remain and increase over time its commercial and productive presence.

The process of international expansion is based above all on the quality of the company's management and on the availability of capital. In fact, managerial capacity must be considered not only as an internal factor to be exploited more effectively with the progress of dimensional development, but as a basic resource for starting such a process. The element that, in fact, makes this expansion possible is represented by the availability of capital. The implementation of direct international investments requires, in any case, the long-term commitment of substantial financial resources, given also the possible lower initial profitability of the undertaken. This means that only companies that have significant equity capital or that are able to draw on it conveniently in the international financial market have real opportunities to achieve efficient internationalisation processes.

Hence the need to rely on a fund such as CVC Capital Partners, a British financial company specialising in *private equity* in sectors such as consumer goods, financial services, telecommunications and pharmaceuticals, which manages more than $52 billion in assets between Europe and Asia, with an investment capacity of $109 billion. *Family business* crises in recent years have become deeper and more frequent and, along with internationalisation, diversification has also become a tool to protect family wealth. If one sector suffers a recession, activities in other sectors can generate funds that allow a company to invest for the future while its competitors are retreating.

Over time, systemic conditions begin to change and make it impossible to maintain autonomous control of the *family business*. Indeed, the need for new resources - managerial or capital - forces the entrepreneur to make new choices. This is the moment when the company opens up to third-party capital and professional management, the antechamber to a different business model, timeshare, no longer familiar or, in any case, certainly not purely familiar.
In essence, according to this vision of the family business model, there comes a moment in its life cycle in which you are forced to abandon the initial structure because, in order to grow, there is a need for new financial and managerial resources that can no longer be provided by the founding family of the company.
This choice was made by Rino Mastrotto Group Spa, which turned to the NB Renaissance Partners fund, which supports ambitious entrepreneurs and management teams with the aim of creating market-leading companies.
NBRP is the result of the *private equity* experience of Intesa Sanpaolo, which has been one of the largest providers of growth capital to entrepreneurs and management teams in Italy for over 15 years.
Since 2015, NBRP has been part of Neuberger Berman, an independent, employee-owned, private investment manager with $315 billion, over 2,000 employees and offices in 34 cities worldwide. Today, NBRP manages €1.5 billion of commitments from a pool of high-quality Italian and international investors and is currently invested in 16 companies, including some of the excellence of the Italian industrial footprint and NBRP plays a leading role in the growth of the real economy.
NBRP has a team of 25 Neuberger Berman private equity professionals in Italy, supported by the largest Neuberger Berman private equity platform of over 150 professionals with offices in Milan, Luxembourg, London, New York, Dallas and Hong Kong.
The choice of *private equity* for the two Italian tanneries responds to the need to address their managerial challenges - internationalization and diversification - and financial relying on new investors in order to see the growth of the vision of their companies and see them grow over time allowing a continuous generational change.