Department of Business and Management - Master’s Degree in Corporate Finance

Chair of Advanced Corporate Finance

The impact of Private Equity operations on the performance of target companies

An empirical analysis of Italian SMEs

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Introduction

Over the last decades the Private Equity industry has developed into an important component of corporate finance. The objective of the following paper is to offer an overview, as exhaustive as possible, of the universe of Private Equity, trying to understand, through an empirical study, the real impact that Private Equity investments have on small and medium-sized enterprises subject to investment, within in the Italian market.

The first chapter aims to frame the phenomenon of Private Equity, defining its characteristics and limits in detail, differentiating it from other similar forms of investment included in the Private Capital universe, such as Venture Capital and Private Debt. The chapter deals with various relevant aspects of the private equity universe, such as the definition and sphere of influence, the governance and organizational mechanisms adopted, the relationships between the players involved in investment transactions and the main performance measures adopted are analyzed. At the end, an overview of the trend of the Italian private equity market in Italy is proposed, using data provided by the AIFI reports, thus underlining the trend in the number of transactions, the amount invested, the distribution of transactions by geographic region, by industrial sector, by type of target company. These data are then compared with analogous data provided by Invest Europe regarding private equity operations carried out in Europe.

The second chapter introduces and analyzes the different types of investments adopted by private equity operators and the various investment steps. The clusters examined include four types of investments, namely growth capital, buy-outs, turnaround, replacement, some of which will be studied in the final empirical analysis. As regards the steps that a Private Equity operator must go through to make an investment, there are three phases: Fundraising activity, which focuses on collecting the resources necessary to make the investments; Investing activity, which is the core process of the Private Equity business as it involves the decision making and deal making phases; Exiting activity, the phase in which the monetization of the value creation achieved during the investment period takes place. At the end of each paragraph, the theoretical framework, in relation to the type of phase analyzed, is supported by statistical data, extrapolated from the PEM (Private Equity Monitor) database, regarding the state of the art of Private Equity activity in the Italian market.

Once the phenomenon of Private Equity, its dimensions in Europe and Italy and the operating mechanisms have been precisely outlined, the third chapter aims to illustrate the impact of a Private Equity investment on the target company and the specific available tools to increase its performance. The third chapter, therefore, proposes a review of the past Italian and international literature, aimed at understanding whether the intervention of a private equity operator actually delivers a positive impact on the target companies and if this is not limited to the contribution of new financial resources but rather, to enable the company to enter a new phase of the life cycle, influenced and supported by the collaboration of a professional interlocutor. Finally, as a preparation for the final chapter, some past research is reported regarding the impact on the performance of these investments on the Italian SME market, which represents more than 90% of Italian companies.

The fourth and final chapter contains an empirical study that aims to examine, with reference to the Italian SME market, the effects of Private Equity investments on the main economic-financial indicators (Revenues, EBITDA, Net Profit, Total Assets, Employment Rate) of the companies being invested. After a methodological introduction, which describes the method of analysis and the sources used, the main characteristics of the sample examined are presented, after which the outputs resulting from the study in question are illustrated. Finally, the results obtained are compared with some benchmarks, such as main macroeconomic indicators (national GDP and employment growth rate), the ISTAT database on Italian companies and the Mediobanca-Unioncamere research on Italian small and medium-sized industrial enterprises. At the end of the investigation, a study is carried out on the companies themselves, analyzing the financial statements before and after the investment date (with a three years' time horizon). The objective of this last analysis, not frequently found in past literature, is to examine the change in the annual growth rates of the previously mentioned dimensional and income indicators, in order to understand if there is a significant impact on performance due to the investment, or whether such growth was already present before the operation took place.

In the final conclusions, a summary view of the results obtained following the empirical research is proposed, comparing these outputs with past literature, with the aim of outlining the role that Private Equity assumes and its contribution to Italian medium-sized enterprises' market.

I. Chapter One: The Private Equity Industry

i. Definition and characteristics of Private Equity and Venture Capital

The private equity market is an important source of funds for start-up firms, private middle-market firms, firms in financial distress, and public firms seeking buy-out financing. Over the past years it has been the fastest growing market for corporate finance, by an order of magnitude over other markets such as the public equity and bond ones and the market for private placement debt.[1]

Private equity is often confused with venture capital, as they both refer to firms that invest in companies and exit by selling their investments in equity financing. At the beginning of the 80's, the expression "venture capital" was defined as the contribution of share capital, or the subscription of securities convertible into shares, by specialized operators, in a medium-long term average time frame, carried out towards unlisted companies with high development potential in terms of new products and services, new technologies, and new market concepts.

Within this definition, participation was generally understood as temporary, minority and aimed, through the joint contribution of not only financial know-how, to the development of the company, to the increase in its value and the possibility of achieving a high level of capital gain on disposal.

It is possible to affirm that the investment activity in the risk capital of unlisted companies is naturally attributable, albeit with different forms and methods of realization, to all those economic systems having a flourishing commercial activity, regardless of the historical period of reference.

While the recognition of the birth of a real private equity and venture capital market is usually traced back to some events that occurred in the United States during the 1940s, in Italy, the start-up year of private equity sector is conventionally traced back to 1986, when nine private and bank-based financial companies founded AIFI (Italian Association of Private Equity, Venture Capital, and Private Debt), with the aim of formally recognizing the activity of investing in risk capital market carried out by professional and specialized operators and give an institutional voice to the common will to establish and develop an Italian risk capital market.

Considering the purely terminological front, the institutional investment activity in risk capital today takes on different connotations depending on whether one considers the most widespread practice in

[1] N. Liang, *The Economics of Private Equity Market*, Federal Reserve Bulletin, February 1995.

USA or in Europe, i.e., whether venture capital is considered distinct from private equity or as a sub-unit.

In the United States, this form of intervention is divided into two autonomous categories, venture capital and private equity. The first includes all operations aimed at companies in the early stages of life or at a later stage of development, while the second concerns mature companies. As evidence of this separation, there are two different reference associations in the United States: the NVCA (National Venture Capital Association) which represents operators who invest in the transformation of new ideas into companies, which could not be financed by the traditional banking channel and which require five to eight years to reach maturity, and the American Investment Council, which represents all those who invest in mature companies, with development potential, to work alongside them with the aim of making them grow.

The clear separation between the two investment categories not only reflects the life cycle of the company, but also includes distinctions relating to reputation, the process of selecting target companies, value creation and exit, characteristics that make them, according to many scholars, so different as to be irreconcilable.

In Europe, however, venture capital activity is regarded as a part of private equity. According to Invest Europe (European association representing private equity and venture capital funds), formerly EVCA, private equity is defined as an entity that makes long-term investments in small, medium, and large companies with the aim of making them larger, stronger, and more profitable, while venture capital can be described as a private equity investment that focuses on start-ups.[2]

In the wake of European practice, in Italy, AIFI has defined the private equity activity as "investment activity in the risk capital of unlisted companies, with the aim of enhancement of the investment company for the purpose of its disposal within the medium-long term".[3]

Having defined the private equity activity, venture capital is part of it as a species within a genus. Venture capital does not therefore constitute a different activity distinct from private equity, but a particular private equity activity aimed at financing the company in the first phases of the life cycle, which are particularly delicate and “adventurous” (hence the definition of venture capital). In this

[2] *Definition provided by EVCA.*
[3] *Definition provided by AIFI.*

regard, according to the moment in which the intervention of the operator occurs, the expressions seed, start-up and later stage financing are used.

Again, with reference to the phases of the normal life cycle of the company, the private equity investment aimed at supporting the already well-established company is defined as growth capital (or expansion capital) and has the aim of supporting the enterprise in the development of new products or technologies, in entering new sectors or markets, in internal growth or through acquisitions, even of international nature. In this regard, it should be noted that, although there is no univocal literature, venture capital activities in a broad sense often include, in addition to seed, start-up and later stage investments, also those of growth capital. In this paper, however, growth capital operations will be defined and analyzed as private equity transactions only, distinct from venture capital.

Private equity can also be used to deal with the transfer in the ownership structure of a company or its general reorganization: this activity is defined as a buy-out and generally determines a change in the control structure. If, on the other hand, the investment concerned the acquisition of a minority stake to replace one or more shareholders, we speak about replacement. Finally, with reference to investments focused on non-ordinary and pathological cycles of the company, such as corporate restructuring, the definition of turnaround is used.

Compared to the classification described above, as will be illustrated in the following paragraphs, today the private equity business has evolved, although the basic assumptions remain unchanged, diversifying according to the reference business system and the degree of development of the various markets, coming to offer a more varied range of intervention possibilities and different operating models. With the new regulatory environment following the 2008 crisis, in fact, banks have not been able to extend most of the corporate and transactional loans that they used to offer.[4]

In parallel, the historical players of the private equity market have in many cases expanded the perimeter of activity to other segments of the financial market, enriching their offer of new products, primarily with reference to the private debt sector, which often allows to support business expansion processes, with important complementarities with the private equity market.

In addition, the sector has also massively extended its action in infrastructure, real estate, energy, and other natural resources, becoming an active protagonist of the new scenario. Secondary markets have

[4] G. Matthews et al., *Operational Improvement: The Key to Value Creation in Private Equity*, Journal of Applied Corporate Finance, Volume 21 n°3, 2009.

reached unprecedented scale and maturity, with transactions of record value, eliminating the main perceived barrier to investing in this asset class, which is its liquid nature.

At fund level, investment vehicles have become increasingly creative and diversified: direct investment by internal teams of sovereign wealth funds or large institutional investors, non-traditional structures, such as club deals, and co-investment between traditional operators and other subjects (companies, family offices, and other types) ensure that private equity constitutes a much broader concept than that envisaged by its conventional definition.

The market in question, therefore, has seen a massive expansion towards new types of activities, in addition to its traditional areas of venture capital, expansion and buy-out, although the latter continues to represent the most significant part of the market in terms of capital size, making private equity a leading player in the global M&A market.

The new construction strategies have become more sophisticated and articulated. As a result, the overall growth of these new sectors has reached such a magnitude that the industry has now commonly changed its brand from "private equity" to "private capital" to better capture its broader dominance. In addition to this, the market has become increasingly transparent, marking a positive evolution for the sector.[5]

This growth was initially favored by the disclosure obligations required by institutional investors and, in recent years, by the growth in the importance of information, not only of financial nature (think about the growing importance that ESG parameters is assuming).

In conclusion, at a national level today private capital, which encompasses private equity, represents a fundamental asset class for institutional investors, having become a mature segment of our financial market, transparent and professionally managed.

Considering these elements, in the continuation of the paper the characteristics of the private equity investment activity will be described and analyzed in detail, using the European terminological practice, and specifying, where possible, the different phases of intervention to which it refers.

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[5] G. Fraser-Sampson, *Private Equity as an asset class*, Second Edition, Wiley Finance, 2010.

ii. Private Equity Funds: Organizational Structure and Performance Measures

Similar to a mutual fund or hedge fund, a private equity fund is a pooled investment vehicle where the adviser pools together the money invested in the fund by all the investors and uses that money to make investments on behalf of the fund.

Over the years, the private equity market has undergone profound changes both in quantitative and qualitative terms. Depending on the target companies being acquired, a distinction can be made between funds that invest in shares of large companies (large buy-out) and funds that invest mainly in small and medium-sized companies (mid-market buy-out), funds that favor healthy growing companies and funds that aim to restore companies in crisis. Also, worth mentioning are the funds that invest in infrastructure, renewable energy, production plants, etc.

Geographically, pan-European funds are distinguished from domestic ones, and in some countries, for example in Italy, there are funds whose specific investment objectives are to support certain regional areas.[6]

A further criterion for market segmentation is represented by the size factor. In particular, local funds, whose activity is dedicated to companies located within national borders, which have sizes between 50 and 500 million euros, are distinguished from global funds, whose investment activity is dedicated to companies localized in any geographic market, which reach sizes between 2 billion and 10 billion euros.

The substantial majority of private equity investments, at an international level, is made through funds, whose legal structure is that of a limited partnership (Table 1).

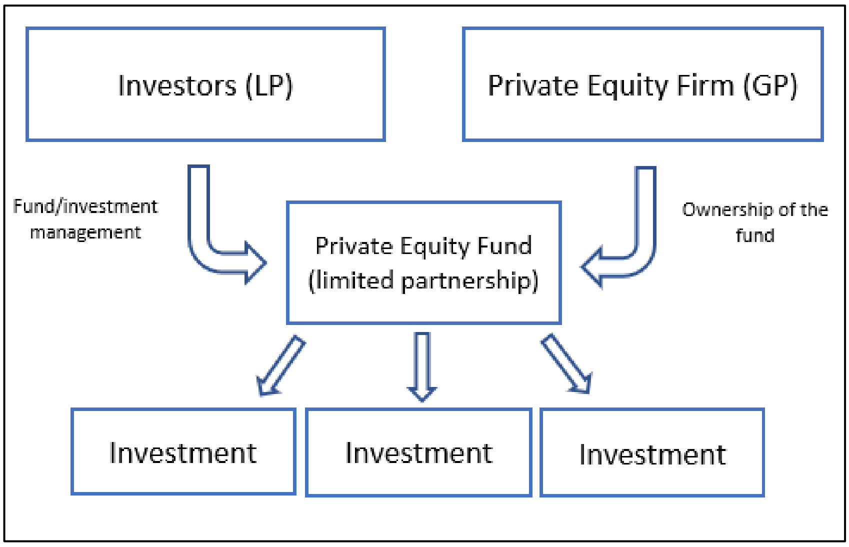

Table 1. Source: Self-elaboration, 2021.

[6] AIFI, *L'investimento in un fondo di private equity: guida al processo di selezione e due diligence*, 2012.

This mechanism is based on an agreement between the so-called limited partners (investors) and the general partner (the manager of the fund). The general partner (GP) is unlimitedly liable to third parties, including personal assets, for the obligations of the limited partnership. The limited partners (LP) have the benefit of limiting their liability to the share of subscribed capital. Only certain prerogatives of extraordinary administration and control remain with the limited partners, such that of resolving the removal of the general partner, the liquidation of the vehicle or the power to prohibit the realization of operations in conflict of interest.[7]

The main role of the private equity firm is to provide investment advice to the private equity fund created in joint partnership with the investors. The firm which acts as a general partner of the fund, also executes investment decisions, oversees the fund's investments, and receives fees for these services.

The professionals of private equity firms often have a wide variety of skills and experience and, generally, investors view the element of diversity in the creation of the investment team as a positive one. To raise funds successfully, investment teams have to present a convincing and deliverable investment strategy, appropriate investment credentials, and, fundamentally, evidence of prior success in executing a similar investment strategy.

To make a fund an attractive investment proposition, not only must the fundamental investment strategy appear attractive, but the LPs must believe in prior alignment of interest between the LP and the GP. The alignment is achieved in several ways[8]:

- *Reputation*: the GPs must establish a favorable track record to raise new funds, as reputation plays a key role because the market consists of a few actors that repeatedly interact with each other.
- *Equity Interest*: the GPs typically make a substantial commitment to the fund that contributes to the alignment of interest with the investors. The significant participation of the GP ensures that they have so-called "skin in the game".
- *Incentive schemes*: GPs operate under a pay-for-performance scheme in which most of their expected compensation is a share of the profits earned on investments, so-called "carried interest".
- *Direct control mechanism*: investors stipulate direct control mechanisms in the partnerships agreements and participate in advisory boards.

[7] A. Gervasoni, F. Sattin, *Private Equity e Venture Capital: manuale d'investimento nel capitale di rischio*, Guerini Next, 2020.
[8] E. Talmor, F. Vasvari, *International Private Equity*, Wiley 2011.

Investors in private equity funds are the entities that provide capital to the fund. They provide the equity capital which is governed by strict legal rules (established in the limited partnership agreement) and task the GP with executing the prescribed investment strategy of the funds and delivering risk-adjusted returns. The LPs are effectively passive investors with no influence on the investment matters of the fund once it is established.

However, it is normal for funds to establish an advisory board. This board is typically formed by the larger and more experienced LPs involved in the fund. The advisory board normally meets twice per year and its role is to provide guidance and support in matters relating to the running of the partnership and to deal with any potential conflict of interest issues that arise. LPs who are not members of the advisory board rely on the annual meeting of the fund and the quarterly reporting provided by the manager as the formal means by which they are informed about the progress of their investments.[2]

The principal investors in a private equity fund are institutional investors such as pension funds, investment funds, endowment funds, insurance companies, banks, family offices/high net worth individuals and fund of funds, as well as the private equity fund managers themselves.[9]

In addition to private entities, the public operator can also decide to intervene to support the economic system. The public entity is usually represented by governments, institutions, publicly owned investment vehicles, funds of large development banks of the various European countries and local authorities that collaborate with institutional investors to boost local businesses. Private individuals are, in this context, represented by entrepreneurial realities, mainly small and medium-sized unlisted companies, and by venture capital and private equity funds.

Regardless of its recent developments, the international market for private equity and venture capital funds has presented, in the course of its evolution, such characteristics that have motivated the intervention of the public actor through schemes that give life to entities with mixed capital: "public-private".

From the analysis of the experiences of public-private schemes it emerges that the public entities should always intervene alongside private ones and with sharing the view of additionality. The public entity is responsible for identifying the economic policy objectives and recognize the most suitable instrument. The policy undertaken by the public entity must be focused, since it documents the fact that the intervention is more effective if it is concentrated in specific sectors or business phases. Therefore, in the case of direct intervention or co-investment with private investors in companies,

[9] J. Gilligan, M. Wright, *Private Equity Demystified: an explanatory guide*, Oxford University, September 2008.

public resources must be disbursed "pari passu" with private ones and must not be related to particular governance rights, trying to avoid a non-optimal allocation of resources and the increase of barriers to entry into the private capital sector.[10]

Most LPs invest in private equity for strictly financial reasons. Some of the financial benefits that are expected from private equity investments are:

- ❖ Attractive risk-adjusted returns (from the best performing funds).
- ❖ Lower correlation to the returns of other asset classes.
- ❖ Benefits of active ownership.
- ❖ Diversification away from the public markets.

By investing through a fund partnership rather than directly in the firms in which these funds buy stakes, the investors also gain access to highly skilled investment professionals with demonstrated abilities. Investors delegate to these professionals the responsibilities of selecting, structuring, managing and eventually liquidating the private equity investments.[11]

The private equity funds are established as a "blind pool" of capital. Consequently, once LPs commit their investment to the found, only the GPs have discretion on how to invest money and when to invest it or return it. Most private equity funds are "closed-end" funds, as investors cannot withdraw their investment until the fund is terminated.

Private equity funds have several important characteristics that distinguish them from other alternative investment funds such as hedge funds[4]:

- ❖ *Life of the found*: each private equity fund or partnership has a contractually fixed lifetime, generally 10 years, with provisions to extend the partnership.
- ❖ *Committed capital*: upon launch, only a fraction of the investors' committed capital will be payable. The balance is drawn when investments are identified by the GP. As a result, the capital calls are irregular. This drawdown feature minimizes the holding period of the investor's capital.
- ❖ *Investment characteristics*: the fund's investments are mainly in private companies which are highly illiquid.
- ❖ *Investment cycle*: during the first years (normally 5 years from the date of the final closing of the fund) the partnership's capital is invested into companies. Thereafter, the investments are

[10] A. Gervasoni, *Private Equity post Covid-19: pubblico e privato, una convivenza da costruire*, Bancaria, June 2020.
[11] E. Talmor, F. Vasvari, *International Private Equity*, Wiley 2011.

managed and gradually liquidated. As the investments are liquidated, distributions are made to the limited partners in the form of cash or securities. When all investments are fully divested, the limited partnership can be terminated or "wound up".

Because of the limited life of a private equity fund, the GPs must regularly raise new funds. The legal rules concerning the raising of subsequent funds are usually contained within the limited partnership agreement. Typically, GPs cannot embark on the raising of successor vehicles until 75% of the committed capital of the current fund has been called or the investment period of the current fund has ended. The fundraising process is time consuming and costly and, on aggregate, can take anything from several months to as many as 18 months.

Private equity funds have a similar fee structure to that of hedge funds, typically consisting of a management fee and a performance fee. The bulk of the fixed revenue earned by the GPs comes from management fees, calculated as a percentage of the fund's size. Typically, when the fund is in its investment period the management fee amounts to between 1% and 2% of the total committed capital of the fund. This fee is used to pay for the day-to-day expenses of managing the fund. This includes the full costs of maintaining the investment team and generally conducting the investment business. Among smaller funds (involving less than € 1bn) the typical fee is 2%. Significantly larger funds normally operate with lower fee percentages to reflect the aggregate scale of the fund.

In addition to management fees, all GPs earn variable (performance-based) revenue from carried interest. The GP's carried interest reflects the share of the aggregate profits that the GP can claim from a successful investment. Carried interest is calculated and paid on the entire fund of LP interests as it allows for better alignment of interest between the LP and the GP. However, in certain circumstances, carried interest can be generated on a deal-by-deal basis. This is a relatively rare structure in Europe; however, it is considerably more prevalent in the U.S.A.

Normally, funds charge a fixed carry of 20% of the profits of the fund. This means 20% of the gross capital gain generated by the fund is distributed to the GP (and then subsequently allocated among carry-holding individuals pro rata to their respective interests).

The remaining 80% of the gross proceeds are distributed to the LPs pro rata to their individual investments in the partnership. To protect the interests of LPs, most carry schemes employ a "hurdle" return (*hurdle rate or preferred return*). Typically, this is set at 8% and means that carry only becomes payable after the cost of investments has been returned plus the hurdle return on the capital cost of these investments which grows at 8% compounded per annum. Under these terms, for example, LPs would receive every euro of exit proceeds until they had received back their entire committed capital plus the hurdle rate, and then the GPs would receive 20 cents of every euro after that.

Another approach is for the GP to "catch up" with the LPs after the preferred return is paid. In other words, the GPs receive more than 20 cents of every euro, after the payment of the preferred return, for a period until they receive the full 20% of the gross profits that were initially distributed to LPs. The presence of a hurdle rate in the partnership agreement achieves a few objectives:

- ❖ It discourages the GPs from taking excessive risks.
- ❖ It motivates the GPs to exit the investment early.
- ❖ It ensures that the LPs obtain a minimum return that is potentially superior to public market investments.
- ❖ It eliminates GPs that are not able to deliver a successful investment strategy.

In addition to management and carry fees, GPs sometimes charge deal and monitoring fees that are paid by the portfolio companies.

An investment in a private equity fund reflects an investment in a stream of cash flows provided by the underlying portfolio companies. In this case the timing and magnitude of the series of cash flows is highly uncertain. The GPs can draw down the money over a period of up to 5 years from the fund's inception and might not draw down the entire committed amount. Similarly, the GPs distribute the proceeds from the fund's investment back to the investors as they are realized but the timing and the amounts of these realizations cannot be predicted in advance because many times they are dependent on market conditions. As a result, measuring the performance of an investment in a private equity fund is not obvious.

The private equity industry typically computes two sets of measures to determine the performance of a private equity fund: multiples and internal rate of return (IRR). These are computed during the fund's life based on portfolio company valuation estimates.

Return multiples are probably the most popular way to assess the performance of a private equity fund investment. They are computed by dividing the value of the returns from the private equity fund by the amount of money invested. These ratios of "proceeds over investment" are simple to calculate and easy to interpret. Funds typically report three multiples: distributed value to paid-in ratio, residual value to paid-in ratio and total value to paid-in ratio. Paid-in capital is the portion of the committed capital that has been drawn down for investments, feed, or fund expenses.

Distributed value to paid-in ratio (DVPI):

$$DVPI = \frac{\sum CF\ (past, received)}{\sum CF\ (past, paid\ in)}$$

where CF (past, received) are net cash flows distributed by the fund as a result of past investments and CF (past, paid in) are cash flows paid into the fund.

This multiple is usually relevant for measuring the performance of the fund towards the end of its life. DVPI shows the net performance of the investment relative to all money that has been used either to compensate the management of the fund or to invest in portfolio companies. DVPI is not a good measure of fund performance when the fund is at a stage where the capital committed has not been fully invested.

Residual value to paid-in ratio (RVPI):

$$DVPI = \frac{NAV\ (T)}{\sum CF\ (past, paid\ in)}$$

where NAV (net asset value) is the fair value of the PE fund's holdings at the date of TVPI computation (T). This ratio is most useful early in the life of a fund before there have been many distributions since it reflects the extent of portfolio companies' revaluation. RVPI shows the current value of all remaining investments (portfolio companies) within the fund relative to the total amount paid-in to date by the investors. This measure is highly dependent on the quality of the valuation estimates provided by the fund and may show a misleading low return if the fund is accounting for its investments very conservatively.

Total value to paid-in ratio (TVPI):

$$DVPI = \frac{\sum CF\ (past, received) + NAV\ (T)}{\sum CF\ (past, paid\ in)}$$

TVPI is perhaps the best available measure of performance before the end of a fund's life. Residual asset values should be subject to conservative accounting valuations and should ideally represent the lower limit of capital that will be distributed at a later stage. The ratio of the sum of past distributions and residual value to paid-in capital therefore should represent the minimum multiple that investors can expect from private equity investments.

The main drawback of multiple measures is that they do not take into account the length of time for which the money has been invested in the fund.

The internal rate of return (IRR) is defined mathematically as the discount rate which, when applied to discount a series of cash outflows followed by cash inflows, returns a net present value (NPV) of zero. The IRR reflects the effects of the timing of cash flows in the private equity fund's portfolio. Thus, private equity returns are calculated and stated not as annual returns of any particular year, but as compound returns from a certain year (formation of the found) to another specified year. As a result, the timing of cash flows in all future years are considered and, therefore, each cash flow is given equal weight by using the time value of money.[12]

Private equity performance can only be assessed by comparing the return of the private equity fund with something else. Investors often have difficulties in finding appropriate benchmarks when attempting to measure and monitor the performance of private equity funds. Generally, they use two sets of benchmarks which are not perfect: peer group (e.g., average return of a group of private equity funds) and public market equivalent (e.g., compare private equity returns with some index of public equities).

Benchmarking the performance of private equity funds is particularly important when investors decide to invest in a new fund. Typically, an investor relies on analyzing the historical performance of the funds managed in the past by the GP raising the new fund. This past performance is then compared with some established peer group indexes published by data providers and/or national industry associations. A judgement is then made depending on whether or how often the GP's prior funds fall within the first- or second-best performance quartiles according to these benchmark statistics. Such a comparison is of value, as it allows assessment of the performance of the GP's prior funds relative to the population of all funds of the same stage and geographic focus that were raised in the same vintage years.[13]

With respect to the second benchmark, the standard approach used in most industry statistics is to compare the long-term IRR of private equity investments with the annualized long-term passive returns from public market indexes. However, this approach ignores important aspects, such as the irregularly timed cash flows of private equity fund investments and the differences in operating and leverage risk between private equity fund investments and the "the market" as captured by these indexes.

[12] A. Gervasoni, F. Sattin, *Private Equity e Venture Capital: manuale d'investimento nel capitale di rischio*, Guerini Next, 2020.
[13] E. Talmor, F. Vasvari, *International Private Equity*, Wiley 2011.

iii. Overview and Comparison of European and Italian private equity markets

After having defined in detail the organizational structure, the core mechanisms, and the internal relationships, of private equity funds, in this paragraph the size and the relevance that private equity currently has on the Italian market, compared to the European one, will be analyzed.

In the last twenty years, private equity in Italy has undergone a significant expansion. Starting from the nineties, a very rapid growth has been observed, leading to the phenomenon of the "new economy", creating a first peak, between 2000 and 2001, in the number of active operators (86 in 2001). In fact, at the turn of those years, the birth of many subjects specialized in the early-stage compartment was registered. Between 2005 and 2010 the market saw a progressive growth of active operators (reaching 129) and also a growth of the average size of managed capital, while following the contraction suffered by the market after the international financial crisis and the difficulties encountered in the collection of new waves, a progressive consolidation was observed which saw the exit from the market of some operators and, more specifically, the aggregation of various initiatives. Today the number of AIFI members has returned to rise and, in 2020, stands at 150, including both domestic and international private equity, venture capital, and private debt operators active in Italy.[14]

Taking into consideration the number of transactions, the following chart represent the trend recorded in the last twenty years.

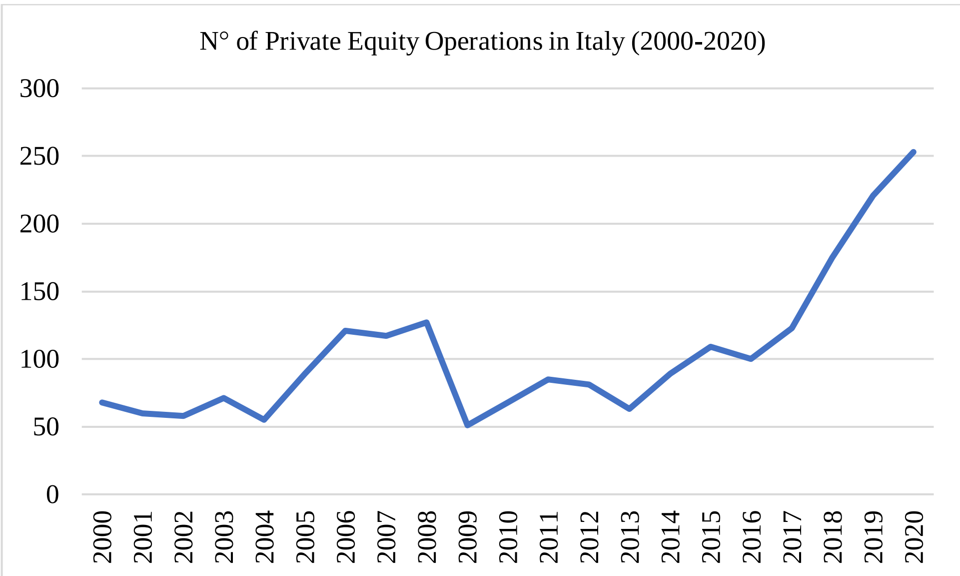

Chart 1. Source: Self-elaboration on Private Equity Monitor data (2000-2020).

From Chart 1 we can see that the evolution in the number of private equity transactions has undergone a growth since the early 2000s, and then stopped and decreased during both the first financial crisis

[14] A. Gervasoni, F. Sattin, *Private Equity e Venture Capital: manuale d'investimento nel capitale di rischio*, Guerini Next, 2020.

of 2008 and the sovereign debt crisis in 2012, which involved several European countries. However, after those years, the market has undergone a strong and unstoppable development which led, in year 2020, to 253 operations recorded in Italy. Moreover, in 2021, the private equity market is at record levels and provides proof of consolidated maturity in a very complex historical phase, registering 160 new investments just in the first semester of the year, while in the same period of 2020, which in any case had already concluded with absolutely positive evidence, 103 investments were mapped.[15]

To outline the current weight that the private equity industry has on the real economy, the following data emerges from the AIFI annual conference in 2021: the companies held in portfolio amount to 1.500 (considering both private equity and venture capital), for a total of 600.000 employees and about 200 billion euros of revenues.[16]

In terms of amount invested by private equity and venture capital operators (therefore not considering the infrastructure segment), the following chart shows the evolution trend in Italy in the last 5 years:

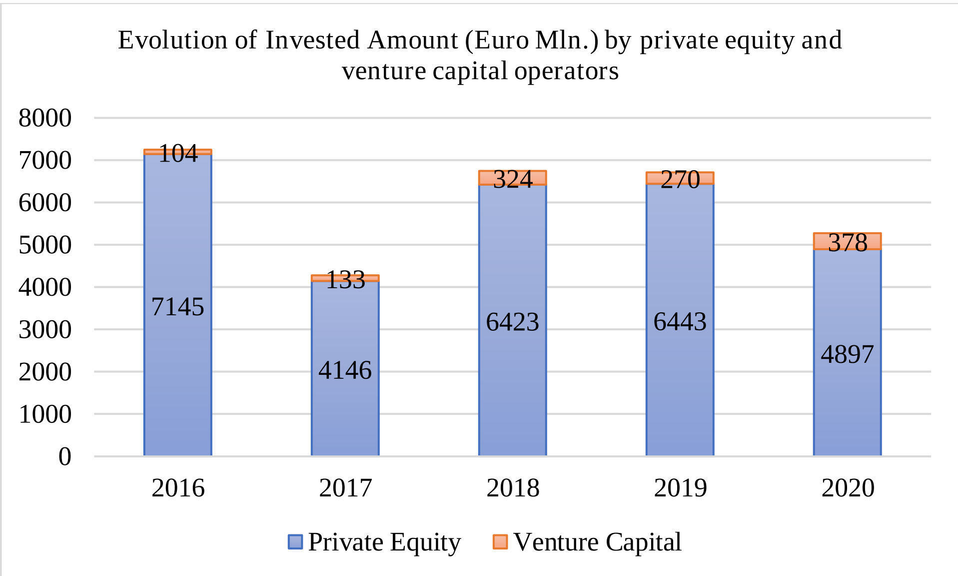

Chart 2. Source: AIFI 2020, Il mercato italiano del private equity, venture capital e private debt.

As we can see from Chart 2, in Italy, year 2020 recorded a total of 5.275 million euros invested, it suffered a slight decline compared to 2019 (-21,4%) mainly due to the crisis caused by the spread of Covid-19 pandemic.

With reference to the European market, the total equity amount invested in European companies decreased 12% year-on-year to €86bn in 2020, compared to the €104bn in 2019. However, this remains 18% above the 2015-2019 average (as shown in Chart 3).

[15] AIFI, *Private Capital Today*, July 2021.

[16] AIFI, *Convegno Annuale*, 19th April 2021.

A total of 8.163 companies received investment, 5% below 2019 but 7% above the average of the previous five years, 85% of which were SMEs.

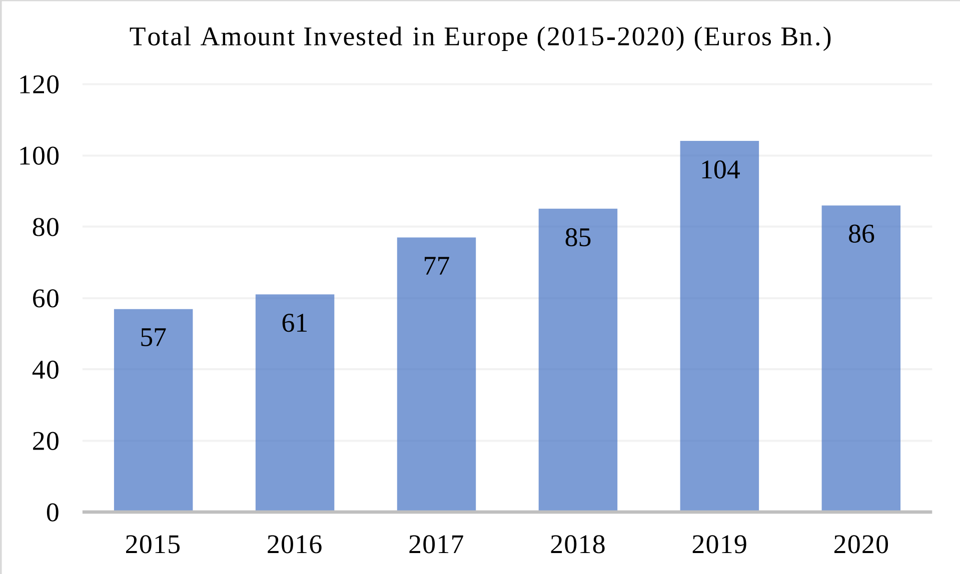

Chart 3. Source: Invest Europe 2020, Investing Europe: Private Equity Activity 2020.

In order to be able to make a sensible comparison between the Italian market and the much wider European one, the following two charts (Chart 4 and 5) illustrate the amount invested, in Italy and in Europe, as a percentage of the respective GDPs in the last 5 years.

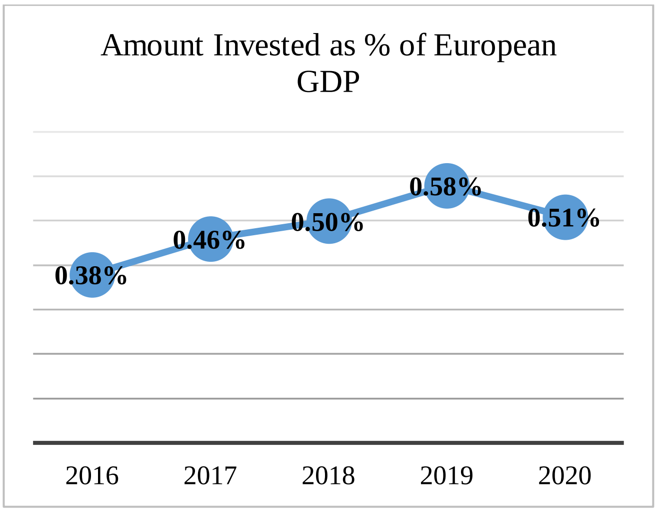

Chart 4. Invest Europe Report 2020.

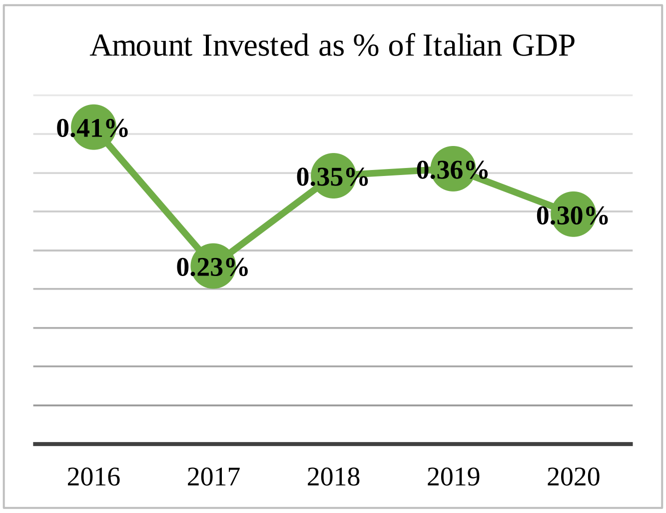

Chart 5. AIFI Report 2020.

We can see that both markets suffered a slight decrease in 2020. The percentages presented in the graphs are not very different from each other, on average the European market, in the last 5 years, presented 0,15% more investments as a percentage of GDP compared to the Italian one.

In these terms, Italy is far behind in the ranking, and the market is dominated by the Netherlands and the UK with about 0,9% of GDP invested.[17]

However, while Italy presents a significant fall in 2017, in Europe the amount invested in private equity operations had a constant increase until 2019, which represents the most prolific year in this sense, reaching and exceeding the pre-financial crisis levels of 2008.

We should also consider that 2020, while presenting a decrease compared to 2019, is still the second-best year of the twenty-first century for amount invested, and the fourth as a percentage of European GDP. As a result, we can say that, despite the pandemic crisis, the private equity market continues to be a fundamental reality, especially with a view to economic recovery.[3]

To corroborate the rough comparison between the evolution of the Italian and European markets, it is necessary to consider first of all the characteristics that the private equity operations investment activity has in Italy, considering the geographical distribution and investment source, the target industrial sectors, and the size of the target firms by number of employees and turnover recorded in the last 5 years (2016-2020). In this comparison, strictly only private equity operations will be taken into account and, therefore: growth capital, buy-out, turnaround and replacement transactions.

The following graph (Chart 6) shows the geographical breakdown of private equity investments in Italy, in the last 5 years:

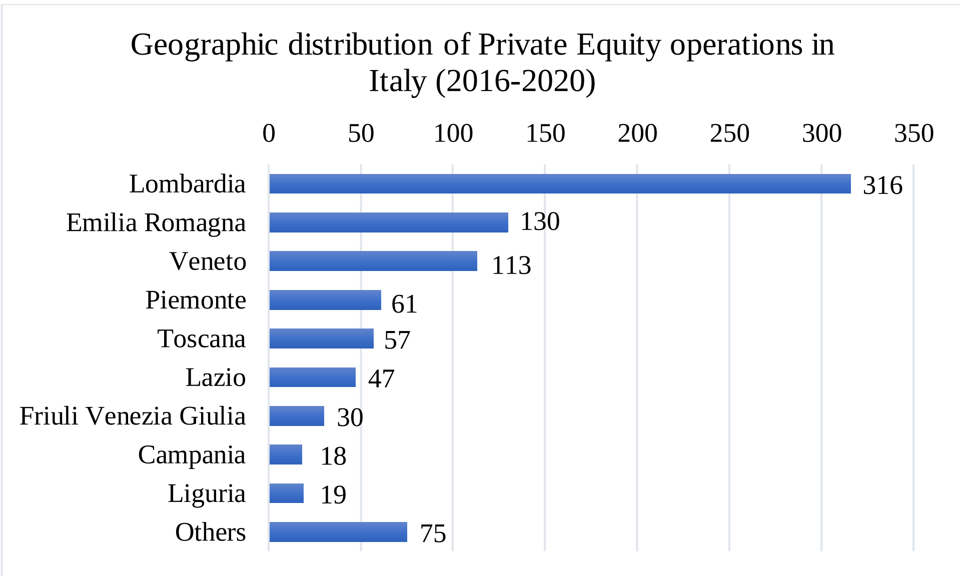

Chart 6. Source: Self-elaboration on Private Equity Monitor data (2016-2020)

[17] Invest Europe, *Investing in Europe: Private Equity Activity in 2020.*

Chart 6 displays a significant predominance of investments made in the northern and central regions, where the largest number of companies (mainly SMEs) is also present.

From data provided by AIFI emerges also that, in Italy, international operators have absorbed 67% of the market in terms of amount invested in 2020, while domestic operators have invested the remaining 33%. In terms of numbers, domestic operators made most of the investments. As a result, although domestic operators make significantly higher number of investments, the amount of money invested is approximately 1/3 of that of investments from international operators.[18]

In Europe, in 2020, most of the equity invested (64%, €56,1bn) came from domestic operators, 29% (€25,7bn) was intra-European (meaning cross-border transactions within Europe), and 7% came from non-European private equity firms investing into portfolio companies in Europe. In addition, about 5% of the investments were made by European private equity firms investing into portfolio companies outside Europe.[19]

The next graph (Chart 7), displays the distribution percentage of private equity operations by target sector:

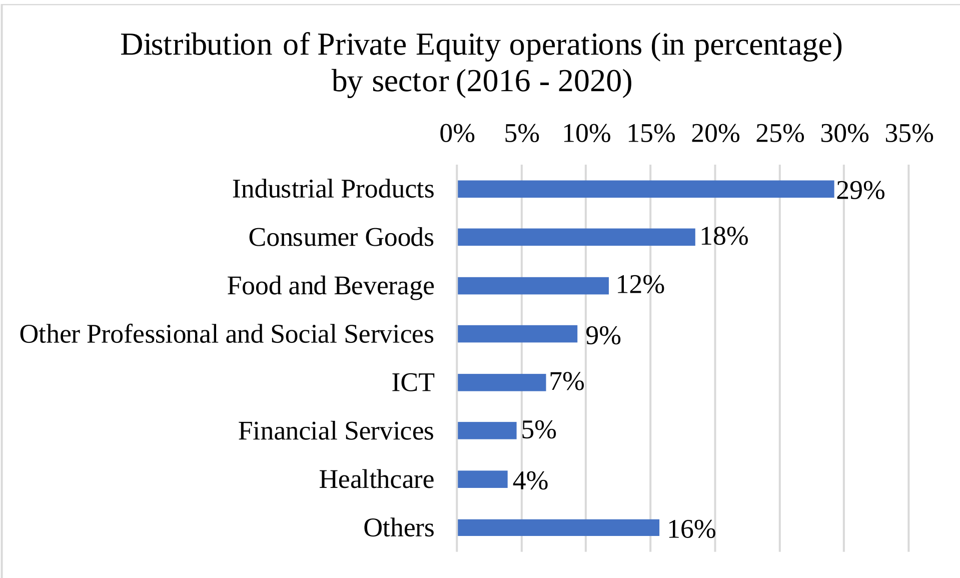

Chart 7. Source: Self-elaboration on Private Equity Monitor data (2016-2020)

In Italy, the Industrial Products sector is the one that has seen the largest number of investments by private equity operators (29% of the total), followed by the Consumer Goods sector (18%) and by the Food and Beverage sector (12%).

[18] AIFI, *Il mercato italiano del private equity, venture capital e private debt*, 2020.

[19] Invest Europe, *Investing in Europe: Private Equity Activity in 2020.*

In Europe, in 2020, the ICT (Information Communication Technology) is the sector with the highest number of investments (37%), followed by Consumer Goods and Services (18,9%) and Healthcare (15,1%). A similar trend was registered in 2019, while the number of invested companies in ICT market remained the same, the amount invested increased significantly from 26,8% to 37,1%.[20]

The last two meters of comparison take into consideration the size of the target companies, in terms of turnover and number of employees, dividing both measures into bands.

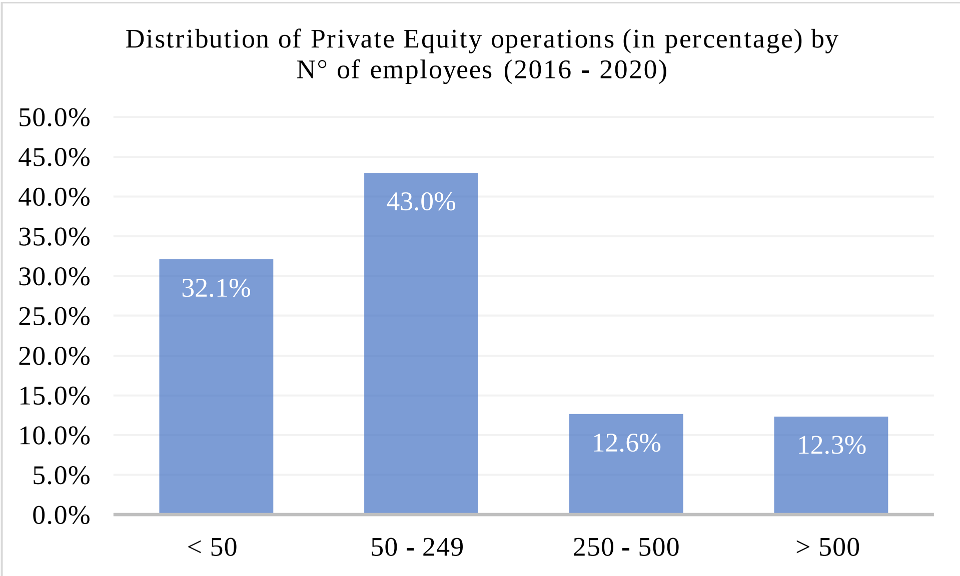

Chart 8. Source: Self-elaboration on Private Equity Monitor data (2016-2020)

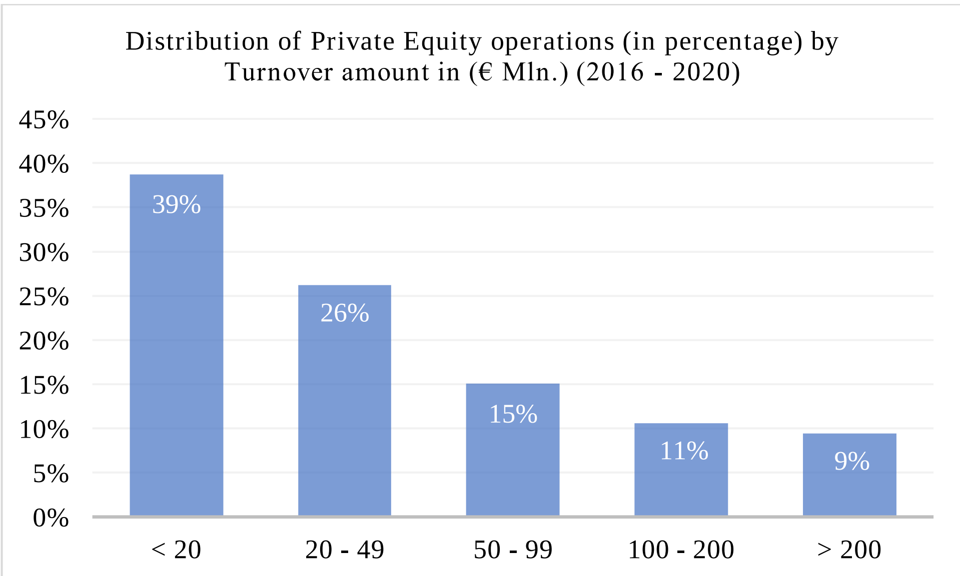

Chart 9. Source: Self-elaboration on Private Equity Monitor data (2016-2020)

[20] Invest Europe, *Investing in Europe: Private Equity Activity in 2020.*

From the two graphs above (Chart 8 and 9), we can therefore state that, in Italy, in the last 5 years, private equity operations have focused more on investments concerning small and medium-sized enterprises, with a number of employees below 250. Also, in terms of turnover, the trend is reflected, as the largest number of transactions involved companies with a turnover of less than 50 million euros. Only 25% of the investments were made in companies with more than 250 employees, and 35% were made in companies with a turnover of more than 50 million euros.

Regarding the European market, in 2020, investments in SMEs (with less than 250 employees) were about 85% in number of companies and 25% in amount invested. In 2019, those investments amounted to 84%, thus confirming a similar trend compared to Italian market (75% investments in SMEs).[21]

[21] Invest Europe, *Investing in Europe: Private Equity Activity in 2020.*

II. Chapter Two: Private Equity Operations

i. Private Equity Investment Clusters

The objective of the following paragraph is to illustrate the main characteristics of the various investment clusters, already mentioned in the previous chapter, that are involved in private equity transactions, in particular: growth capital, buy-outs, replacement financing and turnaround. As already discussed in the first chapter, these four categories will be analyzed considering them, from a European perspective, as transactions attributable only to the private equity sector, thus excluding specific references to venture capital mechanisms.

Growth Capital Operations

Growth Capital, also known as Expansion Capital or Growth Equity, is a type of private equity investment (often a minority investment) in relatively mature companies that are looking for primary capital to expand and improve operations or enter new markets to accelerate the growth of the business.[22] It is precisely the fact that these interventions are often carried out with minority stakes, leaving the entrepreneur to the strategic leadership of the company, which makes them peculiar and very different, in terms of implementation methods, contractual structure, governance and valorization methodologies, compared to interventions carried out as part of the acquisition of a controlling position or venture capital operations.

In general, growth capital includes all risk capital invested in already existing and established companies used to incentivize development, dimensional growth, and potential quotation in a public financial market. This type of participation is less risky than those concerning the initial and start-up phase of a company because there is an already tested and well-functioning company with a significant base of customers.[23]

There is less difficulty in the valuation of these investments because the private equity firm is able to consider the company's historical data and economic information; conditions that are impossible to satisfy in venture capital operations.

In Europe, growth capital investments are one of the most important and widespread private equity activities. They are usually realized by large, closed funds and financial intermediaries with expertise and knowledge about the domestic and international financial markets. The stage of growth of the

[22] *Definition provided by EVCA.*

[23] C. Demaria, *Introduction to private equity. Venture, Growth, LBO & Turn-Around Capital*, Wiley Finance, 2013.

company’s life cycle can be divided into two parts, development (second stage financing) and consolidation (third stage financing).

The second stage financing supports the company’s development (accelerated growth). After commercial validation of the product or service offered by the target company, the private equity fund intervenes and increases production, selling and marketing capacity. The company is still small-medium sized, but the growth capacity of the business idea has improved. It is important to emphasize the fact that the financial resources invested are reduced because the company has already acquired a good part of the market and selling guarantees the resources needed for the production process.

The third stage financing supports the consolidation of the development reached by target company. At this point the company survived the initial development phase and wants to consolidate the market position and the market share, The investor contributes with a large amount of money to protect the target company’s market position and to support the management during the design of new growth plans. These types of plans involve the launch of new products, enlargement or diversification of manufacturing and distribution activities, or the acquisition of a competitor. Consequently, it becomes necessary to collect new funds dedicated to research and development, marketing, and production. As for the previous deals, the company turns itself to a private equity deal not only for financial needs but also due to the number and importance of the available networks that an investor has in the target company’s sector.[24]

Growth Capital operations work best with small or medium-sized companies that want to grow quickly. As such, they have flexible production systems that adapt quickly to the changes that typically occur in growth capital operations. At the same time, it is much more likely that a small company finds itself in this kind of cluster as the growth rates can be much higher than those experienced by a larger company. Companies seek growth capital to reach another indicator for their success, dimension.

Increasing dimension allows the small and medium-sized companies to exploit business opportunities that they otherwise would lose due to the lack or the low availability of effective and alternative tools to catch huge strategic opportunities, such as internationalization.

During the strategic process, the soft support given by private equity investors is critical. Their ability to provide financial resources and a set of advisory services helps the small and medium-sized companies to improve its competitive skills.

[24] S. Caselli, G. Negri, *Private Equity and Venture Capital in Europe: Markets, Techniques, and deals*, Elsevier, 2021.

The support given for the dimensional growth of the firm can be quantitative and qualitative. The company's performance can grow quantitatively, meaning that we can compare the performance of a target company in terms of revenue and number of employees with respect to a non-private equity backed company, and qualitatively, as an expansion deal can lead, for example, to facilitate the collaboration and joint venture with foreign partners that can result in export businesses. As a result of this, growth can occur in two ways in this kind of deals: internally and externally.

In the internal growth deals, the private equity investors compete with banks and other financial institutions. A company seeking this kind of financing wants to pursue growth organically, which means by enlarging itself, by getting new fixed assets, or by increasing its working capital. Hence the investor needs to provide money to the private equity-backed company to buy and/or sustain the procurement of working capital and to purchase new assets. At the same time, the private equity investor may support the company in the potential negotiation with banks for further needs of money. Because this kind of deal is not characterized by a high level of difficulty and at the same time it does not require the private equity to have a strong network (if compared to with other deals), the offer is wide, making this kind of deals less rewarding than other ones.[25]

External growth, from the standpoint of the bidder company, occurs through the acquisition of a target company. M&A operations include a set of heterogeneous deals such as mergers, the acquisition of a business unit of a company, the acquisition of stakes that represent a minor participation in the risk capital of a company, and all deals that allow the transfer of the ownership control. The main reason for M&A operation is to realize a higher total value with the merger of two or more business units or companies than the one that can be obtained if they stand-alone as single units.

According to sector statistics provided by Invest Europe, growth capital transactions represent the second most important category (in value) in Europe after buy-out transactions[26]. However, unlike the latter, which developed in Europe following similar methods to those used in Anglo-Saxon markets (typically USA and UK), growth capital operations have spread in continental Europe, and in Italy in particular, following different patterns than those normally known and studied, highlighting what we could define as an "European way to private equity"[27]. The different entrepreneurial and industrial structure of continental Europe, characterized by the presence of private family-controlled companies, often operating in mature sectors, and equally often exposed to the problems of generational turnover, has meant that many private equity operators have decided to carry out

[25] S. Caselli, G. Negri, *Private Equity and Venture Capital in Europe: Markets, Techniques, and deals*, Elsevier, 2021.

[26] Invest Europe, *Investing in Europe: Private Equity activity 2020.*

[27] A. Gervasoni, F. Sattin, *Private Equity e Venture Capital: manuale d'investimento nel capitale di rischio,* Guerini Next, 2020.

interventions with different structure and methods of implementation compared to those of Anglo-Saxon markets.

It is no coincidence that, in the Italian context, the governor of the bank of Italy, at the time Mario Draghi, in his final considerations in May 2007, paid considerable attention to these precise aspects of undoubted importance for the industrial structure of the country, stating that "intermediaries specialized in risk capital can facilitate the growth of small and medium-sized companies, contribute to the strengthening of the managerial structure, facilitate access to the stock exchange markets, and accompany the generational turnover".[28]

To have a clear picture of how private equity investments impact the expansion of a target company, there are several advantages and disadvantages to be considered[29].

Advantages:

- Screen and Scout of the market: the private equity helps the bidder/private equity backed company in the research of the optimal target to buy.
- Money injection: private equity investors provide the funds necessary to support key business activities.
- Higher overall return: the support of private equity firms allows the original shareholders to obtain a higher return from their investments in the target company, especially when exiting through an IPO.
- Sponsor in going public: experienced investors are key assets in reassuring IPO investors, so their involvement increases the possibility of success in going public. Usually, IPOs realized with private equity investors create higher returns.
- Spin-off support: Investors with a wide range of relationships can help when the target company wants to sell its subsidiaries.
- Private equity improves the target company's ability to satisfy market demands: today markets change quickly due to customer needs or technological revolutions, so it is crucial to a company's success to be able to quickly exploit market opportunities.
- Advisory support: Private equity can support the target company upon entry into new markets or industries because they are able to share their management skills and business know-how.

[28] Banca d'Italia, *Considerazioni finali: Assemblea Ordinaria dei partecipanti*, Roma, 31 maggio 2007.
[29] S. Caselli, G. Negri, *Private Equity and Venture Capital in Europe: Markets, Techniques, and deals*, Elsevier, 2021.

Disadvantages:

- Culture changes: The target company's managers and employees have to work with a new partner who has a high-profit-oriented culture combined with an intense pressure to continue to develop the business.
- Timing and exit strategies may not be consistent with the plan of the original shareholders and management, many conflicts of interest arise while managing the right time to exit.
- Buy back options are usually limited. This means that original shareholders may not be allowed to re-purchase the participation from the investor if the deal was unsuccessful. Private equity firms are usually reluctant to include a buy back option because it can affect the real potential of the investment return.
- Closing a transaction with private equity firms is complex and time-consuming because the type of deal includes agreements on liabilities and obligations that can take up a year to close.
- The willingness of a private equity firm to commit additional financial resources in a specific investment already part of its portfolio is limited by the continuous focus on its expected returns. The situation can force original shareholders into adding new funds to the private equity backed company to avoid losing new business initiatives or opportunities due to lack of funds.

Replacement Financing

After the early-stage growth period (typically supported by venture capital operations), the size of the firm becomes more stable, and the company enters in a mature stage. Although profitability and cash flows are stable, private equity finance still plays an important role. During the mature age entrepreneurs modify their needs and, while almost all priorities were driven by sales development and size increasing, in this period the problems come from governance and corporate finance decisions.

Replacement financing, the typical support from private equity finance for firms in their mature age, funds companies looking for strategic decisions associated with the governance system and the firm's status, rather than the firm's approach to finance. This kind of investment may be realized in different ways:

- Listing on a stock exchange.
- Substitution of shareholders.
- Successions.
- A new design for the company governance.

Replacement financing is never used to boost sales growth or to realize investment in plants. Instead, it is used for strategic or acquisition processes. Replacement capital is the proper solution to fund spin-off projects, equity restructuring, shareholder substitution, IPOs, family buy-in or family buy-out, etc.[30]

For investors, the risk profile of these deals is moderate because:

- ❖ The firm business model is successful.
- ❖ The firm governance is settled even though it is in a shifting phase.
- ❖ Entrepreneurs usually remain and work for the company development.
- ❖ The effective risk depends also on the whole sector/market risk and the quality of the process to be put in place.

Financial institutions operating in this environment could be used as just an investor or as an advisor and consultant. The role of the private equity operator is to support managerial strategic decisions and the implementation of the entire deal design.

At this point, the managerial involvement from the investor is extensive. When the financer acts as more than a financial operator, industrial knowledge and previous expertise become very important. Entrepreneurs need to skillfully manage corporate governance issues and corporate finance deals.

In this case, private equity operators buy a large number of shares issued by the firm they are working for. This makes the whole plan easier to be implemented, and very often the private equity operators turn into prime shareholders.

However, even though the investors hold the majority of the company's shares, they do not participate in the current management allowing the entrepreneur to retain the top management role. Compared to the types of financing used by private equity operators and venture capitalists, replacement financing is the most independent from the actual business; instead, it is related to the personal and private needs of entrepreneurs.[8]

Buy-Out Operations

Buy-outs are defined as private equity interventions that are carried out in order to support the change in the ownership structure of the company involved in the transaction, and therefore where a real transfer of control occurs.

[30] S. Caselli, G. Negri, *Private Equity and Venture Capital in Europe: Markets, Techniques, and deals*, Elsevier, 2021.

Buy-out operations are therefore characterized by the fact that, within the investment, a change in the controlling structure occurs, which is normally acquired by the private equity operator (or by a group of operators), with all the consequences and responsibilities that this position entails. It is for this reason that these operations differ substantially from those of growth capital seen previously, which mainly referred to the purchase of minority stakes by private equity investors, and certainly also with respect to those of venture capital and early-stage financing. It is not a "partnership" with the entrepreneur, although this may in some cases happen.

In these transactions, the investor's partner is almost always the management, or rather, a management team or an aspiring entrepreneur, who is normally also involved at a shareholder level from the early stages of analysis and structuring of the transaction, that will have to deal with the management and implementation of strategies, aligning his interests with those of investors.

However, the management team is almost never able to acquire stock control of the company, indeed, this is quite rare. Almost always, in these operations, the share control is held by the private equity operator, who plays the role of majority shareholder. Consequently, regardless of the shareholding acquired, management and current operational responsibility of the company passes into the hands of the management team, and the investor normally focuses his role on that of strategic direction, support for development, monitoring and evaluation of results.

From a terminological point of view, all these operations are included in the macro-category of buy-outs, within which it is however possible to identify different subspecies, based on the characteristics of the new property or, more precisely, on the economic entity that will deal with the management of the company once the transfer of control has been carried out.

The first distinction is made between management buy-out (MBO) and management buy in (MBI), depending on whether it is an internal or external group that takes control from the management point of view. We refer to employees or workers buy-out (EBO) if the investor is aimed at favoring a new ownership structure that sees the involvement of a wider team, including the employees of the company itself. We talk about family buy-out when the management control is taken by part of the family members interested in the continuation of the business activity.[31]

Also due to frequent simplification, especially with reference to buy-out operations, there is often a tendency to confuse the company acquisition process carried out with the contribution of one or more

[31] S. Kaplan, P. Stromberg, *Leveraged Buyouts and Private Equity*, Journal of Economic Perspectives, Volume 23 N°1, 2009.

institutional investors with the financial structure set up for the transaction, using leverage (leveraged buy-out, LBO).

As will be fully discussed below, it should therefore be emphasized that by LBO we mean any acquisition of companies or company assets carried out mainly by using third party capital (generally financial institutions) and limiting the buyer's financial investment, in terms of risk capital, only to a limited amount of the price. The borrowed capital, in turn, must be repaid through the active cash flows produced by the operating activity of the target company or through the sale of part of the assets acquired.

The use of this methodology, albeit extremely frequent, is not indispensable for all cases of company acquisition in which an institutional investor participates, as well as not all leveraged buy-out operations, which include most of the takeovers carried out by listed companies, can be cataloged among those of private equity. However, it has been statistically demonstrated that the very large part of the buy-outs carried out by private equity operators are realized using the leverage mechanism. In fact, in its official definitions, Invest Europe defines buy-outs as follows: "Financing provided to acquire a company. It may use a significant amount of borrowed capital to meet the cost of acquisition. Typically involves purchasing majority or controlling stakes".[32]

It should be made clear immediately that not all companies are suitable for being the subject of an LBO. In fact, we have seen that this operation involves a sharp increase in the debt level of the target company. For this reason, the lenders will be willing to intervene only if they can reasonably believe that the company can cope with this greater debt.

Regardless of the situation, the target only represents an attractive LBO opportunity if it can be purchased at a price and utilizing a financing structure that provides sufficient returns with a viable exit strategy.

The ability to generate strong, predictable cash flow is critical for LBO candidates given the highly leveraged capital structure. Debt investors require a business model that demonstrates the ability to support periodic interest payments and debt principal repayment over the life of the loans and securities. Business characteristics that support the predictability of robust cash flow increase a company's attractiveness as an LBO candidate. For example, many strong LBO candidates operate in mature or niche business with stable customer demand and end markets. They often feature a strong brand name, established customer base, and/or long-term sales contracts, all of which are crucial to

[32] *Definition provided by EVCA.*

increase the predictability of cash flow. Prospective financial sponsors and financing providers seek to confirm a given LBO candidate's cash flow generation potential during due diligence to gain comfort with the target management's projections. Cash flow projections are usually stress-tested based on historical volatility and potential future business economic conditions to ensure the ability to support the LBO financing structure under challenging scenarios.

Private equity investors seek companies with growth potential, both organically and through potential future bolt-on acquisitions. Profitable top line growth at above-market rates helps drive outsized returns, generating greater cash available for debt repayment while also increasing EBITDA and enterprise value. Growth also enhances the speed and optionality for exit opportunities. For example, a strong growth profile is particularly important if the target is designated for an eventual IPO exit. Companies with robust growth profiles have a greater probability of driving EBITDA "multiple expansion" during the investment horizon, which further enhances returns. Moreover, larger companies tend to benefit from their scale, market share, purchasing power, and lower risk profile, and are often rewarded with a premium valuation relative to smaller peers, all else equal. In some cases, private equity investors opt not to maximize the amount of debt financing at purchase. This provides greater flexibility to pursue a growth strategy that may require future incremental debt to make acquisitions or build new facilities, for example.[33]

Although an ideal LBO candidate should have a strong fundamental business model, investors seek opportunities to improve operational efficiencies and generate cost savings. The investors may also seek to source new terms with existing suppliers and customers. At the same time, investors must be careful not to jeopardize existing sales or attractive growth opportunities by starving the business of necessary capital.

In addition, a leading and defensible market position generally reflects entrenched customer relationships, brand name recognition, superior products and services, a favorable cost structure, and scale advantages, among other attributes. These conditions create barriers to entry and increase the stability and predictability of company's cash flow. Accordingly, the sponsor spends a great amount of time during due diligence seeking assurance that the target's market positions are secure (and can potentially be expanded). Depending on the sponsor's familiarity with the sector, consultants may be hired to perform independent studies analyzing market share and barriers to entry.

All else being equal, low capex requirements enhance a company's cash flow generations capabilities. As a result, the best LBO candidates tend to have limited capital investment needs. However, a

[33] J. Rosenbaum, J. Pearl, *Investment Banking: Valuation, Leveraged Buyouts, and Mergers & Acquisitions*, Wiley, 2013.

company with substantial capex requirements may still represent an attractive investment opportunity if it has a strong growth profile, high profit margins, and the business strategy is validated during due diligence.

A strong asset base pledged as collateral against loan benefits lenders by increasing the likelihood of principal recovery in the event of bankruptcy (and liquidation). This, in turn, increases their willingness to provide debt to the target. Strength is defined as size of the asset base (e.g., tangible assets as a percentage of total assets) as well as quality asset given their liquidity. As opposed to long-term assets such as PP&E (plant, property, and equipment), they can be easily converted into cash. The target's asset base is particularly important in the leveraged loan market, where the value of the assets helps dictate the amount of bank debt available. A strong asset base also tends to signify high barriers to entry because of the substantial capital investment required, which serves to deter new entrants in the target's markets. At the same time, a company with little or no assts can still be an attractive LBO candidate provided it generates sufficient cash flow.

Finally, a proven management team serves to increase the attractiveness (and value) of an LBO candidate. Talented management is critical in an LBO scenario given the need to operate under highly leveraged capital structure with ambitious performance targets. Prior experience operating under similar conditions, as well as success in integrating acquisitions or implementing initiatives, is highly regarded by private equity investors. For LBO candidates with strong management, the sponsor usually seeks to keep the existing team in place post-acquisition. It is customary for management to retain, invest, or be granted a meaningful equity stake so as to align their incentives under the new ownership structure with that of the investors. Alternatively, in those instances where the target's management is weak, investors seek to add value by making key changes to the existing management team or installing a new team altogether to run the company. In either circumstance a strong management team is crucial for driving the company performance going forward and helping the sponsor meet its investment objectives.[34]

Summing up, the peculiar characteristic of these operations therefore lies in the fact that two orders of event occur simultaneously: on the one hand the change of ownership (buy-out) and in this sense it is a simple acquisition; on the other hand, a complete restructuring of the liabilities of the company subject to the sale (leveraged).

[34] J. Rosenbaum, J. Pearl, *Investment Banking: Valuation, Leveraged Buyouts, and Mergers & Acquisitions*, Wiley, 2013.

In order to provide an overview of the basic structure of the typical LBO operation, the main steps that the interested parties face, in a simplified way, are reported below.

The first step of the operation consists in the creation of a company, which we will call *holding* or *newco*, in which some entrepreneurs, who could be the managers of the company or managers from other companies, pay in, normally supported by an institutional investor in risk capital, a certain amount of equity.

However, this amount represents only a small part of the amount necessary for the acquisition of the target company. Therefore, one or more financial companies (step 2) grant a loan to the holding company for an amount such as to cover, added to the capital already paid by the shareholders, the purchase price of the shares of the target company. This loan, being granted to a company with no operating structure, is made on the basis of few, if any, collateral.

With the liquidity available, the holding will now be able to purchase the shares of the target company by paying the agreed amount to its shareholders (step 3).

Once the purchase has been made, the holding company, which will now present among its activities the shares of the target company, merges with the target company itself (step 4). In this way, the loan provided to the holding will become part of the liabilities of an operating company and will therefore eb able to take advantage, in whole or in part, of the real guarantees that this will be able to produce.

As a consequence of the transaction and, in particular, of the large use of third-party financial means, the debt of the target company will be considerably higher after the merger than before the transaction itself.

The transaction could also result in the purchase of the individual assets of the company and not of its shares. This method is unavoidable if the object of the operation is a division or a fixed asset, but it is also used in the event of the sale of the entire company. Although from a logical point of view the structure of the transaction does not change if one or the other procedure is used, from a legal and fiscal point of view, the problems to be faced are very different.

The illustrated example is clearly an extreme simplification, and it is evident that in practice there are numerous problems to be faced and the structure of the operations is normally more complex. However, as mentioned above, it is not the technical or legal method used in the transaction that determines whether or not it is a leveraged buy-out, but its effects on the structure of the liabilities of the company sold and, in particular, on its level of debt.

To conclude, the main possibilities of measuring performance in LBO transactions will be illustrated, which are the internal rate of return (IRR) and the cash-on-cash multiple return (COC).

As we have already seen in chapter one, the IRR measures LBO returns by factoring in the time value of money, meaning that it is important to have a relatively short holding period. However, returns are not risk adjusted, so care must be taken when comparing the performance of different LBO transactions. The IRR captures the total return during the investment period, including interim cash inflows and outflows such as dividends paid to equity holders or additional investments. The IRR can be thought of as the discount rate that would make the NPV zero.

The equation is:

$$\sum_{n=0}^{n} \frac{CF\ (n)}{(1 + IRR)\hat{}n}$$

The COC return is simply a multiple of the initial equity investment in the LBO transaction. It does not factor in the time value of money and, therefore, is not affected by the investment horizon. Therefore, COC and IRR should be considered in combination to provide a more complete picture of performance.[35]

Turnaround Operations

We can define turnaround investing as the investment in a difficult economic and/or financial situation, with the prospect of relaunching it, in order to make a capital gain on the initial investment. This is true both for privately held companies and for listed companies: in both cases it is a question of identifying a firm that has an intrinsic value and a potential capable of achieving better results than the current ones, thanks to certain characteristic (such as market positioning, management, and brand).

This type of investment can be described in another way by referring to the life cycle of companies. In fact, if in the initial and growth phases the company needs capital to develop new products and markets, in the more mature phases situations of "decline" or "crisis" may occur, in which capital is needed to stop the decline in performance and let the company return to physiological levels in terms of profitability and financial situation.

The concepts of decline and crisis can take on very broad and diversified outlines, but in any case, it is a question of the protraction over time of economic-financial imbalances, which, if not managed

[35] E. Talmor, F. Vasvari, *International Private Equity*, Wiley, 2011.

through appropriate reorganization and restructuring actions, could lead the company to a state of insolvency, identified as the inability to meet one's debts.

From the point of view of private capital, turnaround investment is generally given by a set of several elements, of which the main ones are injection of new capital, debt restructuring and managerial strengthening. These three elements may have relative dimensions and different relevance depending on the case, but they are all taken into consideration and are always correlated with each other.

Capital injection plays the central role for private equity investors, while debt restructuring is the element around which the intervention of debt funds revolves. The role of management is always central, as, whether it is confirmed or renewed, it will have to be able to relaunch the company starting from an initial situation that is less critical in financial terms.

It follows that the turnaround is a set of types of intervention rather than a homogeneous category and much depends on the severity of the business crisis. The greater complexity of the turnaround compared to other types of investments also resides in the presence of very different stakeholders: current shareholders, management, the credit system, customers, suppliers and, in cases of insolvency proceedings, the judicial system.

As we have seen, turnaround funds aim to make investments in companies with advanced situations of imbalance, crisis, distress, in order to offer investors a distinct asset class compared to traditional private equity, for example. In other words, turnaround funds focus on that phase of the business life cycle which, if not managed properly, can lead to decline. Therefore, the role or strategy of these funds consists in identifying companies in difficulty to relaunch them through a financial transaction, which uses the instruments of equity and debt in various ways.

In the first instance, the fund's objective is to improve the performance of the company in order to increase its value, by contributing not only capital but also professional skills and experience to support management. Since the company is in a limit situation, the turnaround operators must possess, among other things, leadership skills such as to be able to persuade the company's stakeholders of the opportunity to resort to a fund to save the company's future.

In general, we can distinguish two macro-types of turnaround funds: equity funds and debt funds. The former is actually a variant of traditional private equity funds, in which the target company is in a crisis situation and therefore it is not possible to act on traditional financial leverage, but rather it is necessary to reduce the debt burden on the company assets. Therefore, these are equity funds in which the entire amount of the fund will be allocated to companies with unbalanced economic and financial situations. The limits set in the fund regulations will determine the investment strategy of the management company towards companies with a more or less serious situation in terms of economic-financial indicators.

The private equity investor has to consider four fundamental risks when structuring a turnaround deal:

- *Social Risk*: when a firm is in crisis it strongly impacts both society in general and the firm's stakeholders. During this time, the firm has problems with creditors, suppliers, employees, and customers. The community is affected by the loss of taxes paid by the firm and the costs to support employees who have lost their jobs.
- *Economic Risk*: the economic crisis of a company is analyzed by their return on investment (ROI); if it is lower than average industrial ROI, the company is under performing. This analysis can be problematic, and a better indicator of economic problems is the decline of the entire industry. A company is in crisis when its financial performance is continually decreasing in terms of ROI and return on sales and when net incomes are negative.
- *Legal Risk*: the bankruptcy of a company raises many legal issues.
- *Management Risk*: from a management point of view, a company is in crisis when the ROI starts to decrease. Managers are the first to understand the situation and know if the crisis can be averted.

As in part already highlighted the target companies of a turnaround investment are characterized by a "pathological" situation in terms of ability to produce income, equity and financial situation, level of debt deterioration, relationships with suppliers, etc. A firm is also in crisis when it does not have sufficient financial resources to meet its obligations. We can then sum up the most frequent characteristics of the investment companies:

- *Excess Debt*: it is the situation in which the company has taken on debt for an excessive amount compared to its ability to generate profitability and cash flows, typically to make investments or even for corporate restructuring operations. This situation is not pathological in itself, but which becomes pathological so easily if the investments made turn out not to be proportionate to the performance. Excess indebtedness is not an absolute value: it is in relation to profitability and the ability to generate cash and in this sense, it may not coincide with banking terminologies in terms of impaired credit.
- *Low Profitability*: this is the case in which the company has a low profitability compared to competitors, or even a negative one. In these cases, the deterioration can originate, for

example, from production inefficiencies, positioning or pricing errors, the inability to keep pace with the markets in terms of range of offer, technology, service etc.

- *Asset Imbalance*: this is the case in which the company is undercapitalized in relation to the size of the turnover, debt, working capital; in many cases this occurs in combination with other factors and is frequently found in companies that have to deal with the issue of succession.
- *Management*: in many cases, the target companies have inadequate management to manage the crisis, often it is a self-feeding mechanism; the best managers leave the company that is going into crisis which in turn struggles to find managers willing to face a difficult challenge.

To conclude, we can try to group the success factors of a turnaround into these types[36]:

- *Structure of intervention*: a critical situation needs to fix the lost balance, primarily financial. It is therefore a question of identifying the optimal mix between recapitalization and debt restructuring and the use of other financial instruments.
- *Business Plan*: the soundness of the plan is a key point for making the investment; the monitoring and the ability to adapt the plan to the evolution of the markets represent a decisive factor during the investment period of the fund in the company.
- *Governance*: in a context of crisis, it is essential that the investor possesses the right strategic levers; in this sense, the ideal is a position of control or co-control of the investor. In any case, it is important to create a balanced and "healthy" relationship among stakeholders, aimed at the same goal, represented by the relaunch of the company.
- *Management*: not only is it about finding the most suitable managers for the sector and with the ability to manage difficult situations, but it is necessary to identify and stimulate the elements that bring the right collaboration and full alignment with the investor.
- *Reorganization and Strengthening*: it involves analyzing and choosing between different options regarding the internal organization to be adopted and the lines of business of the company on which to focus.
- *Timeliness*: that is, not only entering the company at the right time but also knowing how to make decisions, even strong ones, at the right times. Furthermore, the first concrete results must occur in a not too long time (indicative within 12-18 months from the investment).

[36] A. Gervasoni, F. Sattin, *Private Equity e Venture Capital: manuale d'investimento nel capitale di rischio*, Guerini Next, 2020.

ii. Fundraising Activity

The financing of private equity companies cannot be separated from collecting the necessary funds to realize the investments. The fundraising activity is fundamental within the managerial process regardless the legal status of the deal, the organizational structure of subjects involved, and the characteristics of firms or projects selected later.

Typically, as already seen previously, there are two broad categories of investors: individuals and institutional investors.

Individuals are ordinary savers who have a remarkable number of resources available for investments, the propensity and the preference for high-risk investments, the desire for portfolio diversification, and the objective of achieving high returns. However, individual investors typically invest significantly less than institutional investors.

Institutional investors, known also as professional investors, have a deep knowledge of the market environment and they are able to accurately understand the risks and expected return of an investment or financing project. Generally, institutional investors have more resources to invest and operate in the medium/long term, as they can ensure private equity firms or venture capitalists a substantial flow of resources and are able to wait a reasonable period of time to achieve their performance targets. As we have already seen, these two categories of investors have the role of limited partners (LPs).

Investors and private equity firms deal with different types of risk. Business risk is borne by private equity operators, as they are in charge of identifying the opportunities and, thanks to the resources committed by LPs, they are able to exploit economies of scale. The limited partners face information asymmetry and the risk of opportunistic behavior by financial institutions. Financial institutions, at least in theory, face the risk of opportunistic behavior by suppliers of funds that cannot face the agreed payments. An appropriate contract structure can overcome these difficulties, despite they cannot be entirely eliminated.

The information asymmetry occurs because the investors have trouble monitoring the private equity firms. Instead, moral hazard is generated from the private equity firms, who generally subscribe up to 1% of the capital with the aim of maximizing their gain and at the same time to diversify the risk. To reduce moral hazard and information asymmetry and to ensure a high rate of success, fundraising has to be deeply studied and structured as a selling game where reputation, mutual trust and "love for gambling" are the pillars of a risky job dedicated to the raising of large amounts of money.[37]

[37] S. Caselli, G. Negri, *Private Equity and Venture Capital in Europe: Markets, Techniques, and deals*, Elsevier, 2021.

Appropriate early-stage design and planning of a fund is of paramount importance for the fundraising phase to be successful and for the firm to start to operate. An advanced planning can be helpful to focus the fundraising team so that effort and costs are not expended inappropriately. They all aim at making the best out of the promotional activity that will be realized by the private equity firm to reach out the largest number of investors in the shortest time possible. The stronger the trust in the reputation and in the track record of the private equity firm, the shorter the fundraising period.

To sum up, there are several activities that should be encompassed and planned carefully before the fundraising even begins.

Among the preliminary activities, allocating costs is surely the most important one. Costs include the out-of-pocket costs that general partners (GPs) will bear to promote the fundraising activity, especially if this activity is carried out on an international level. Moreover, during budgeting activity, it is important to include legal and regulatory charges.

It is important that GPs review any potential restrictions from existing funds or contracts on raising new money and verify the availability of the GP's human and financial resources, in order to market and raise the fund.

Before starting planning fundraising, GPs should define the positioning of the fund. A fund's strategy and positioning depend on the following two variables[38]:

- The *Equity Stake* that the private equity firm aims to have in the portfolio companies. The stake can be either a majority or minority one. It generally depends on the investment cluster, and on whether the GPs want to have a hands-on or a hands-off approach.
- The *Industry Specialization*: there are firms that have specialized teams in specific sectors, in order to provide the best assistance possible to the entrepreneur and in order to achieve a deep understanding of the market.

Thanks to these two variables, it is possible to classify funds in four different types depending on their objectives. In most venture capital deals, GPs are industry-oriented, in light of the high technological content involved in many start-ups products. Growth funds have the purpose of expanding companies that typically already have a strong customer base, they also can hold either a minority or a majority stake. By definition, buy-out deals take over a controlling stake in the target

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[38] S. Caselli, G. Negri, *Private Equity and Venture Capital in Europe: Markets, Techniques, and deals*, Elsevier, 2021.

company. Depending on the private equity firm they can be specialized by industry or not. Finally, generalist or "balanced" funds do not have a specific industrial or degree of control orientation.

Once the target cluster is recognized, it is necessary to identify the human resources that are needed to implement the fund's objectives and to responsibly manage and administer the fund.

Before undertaking the fundraising and all other promotional activities, it is important to forecast the fund's cash flows including the level of management fees, the provisions regarding transaction, advisory or other costs to be incurred by the fund and the appropriate profit share and carried interest structure. The level of management fees and target carried interest has to be consistent with the funds' objectives illustrated above.

Depending on the geographical scope of the fund, it is crucial that GPs plan its form and jurisdiction as well as key structural terms, such as the length of the investment period and terms of the fund, minimum and maximum fund sizes and deal flow allocation between other funds managed by the GP. Nowadays, it is also relevant to consider including responsible investments, such as the ones classified as environmental, social, and governance (ESG).

The first step of the fundraising activity is the creation of the business idea. It starts by explaining the idea to the business community and catch the attention of potential investors. Business idea creation is aimed at producing an information memorandum to be promoted in the market. Before that, a preliminary phase, often called "taste of waters" occur. This is carried on in a very informal way among the professional network, with the aim to assess, for instance, whether it makes sense for the private equity investors to invest in a specific private equity cluster or not.

After managers have received an informal consensus about their activity, a more formal part begins, and the information memorandum is produced. The information memorandum has the objective of explaining the rationale of the business idea to the business community and has to appeal to the potential audience of investors.

The success of the business idea is strongly related to the reputation and to the track record of the private equity firm. Some of the main information contained within the document are the following: choice of the vehicle, target to invest, corporate governance rules, usage and size of leverage, etc.

In United Kingdom and United States, private equity investors are generally structured as a single company that simultaneously manages different funds that are legally separated in a limited partnership.

The typical European structure for private equity activity is the closed-end fund. Like in the case of LPs, it is impossible to commit further capital after the fund has been launched and the investor exit is possible only when the fund expires or by agreement.

Structured, well-planned, and exhaustive communication helps the temporary marriage among the investors. It is executed though the investment plan realized at least annually and within 6 months after the end of the fiscal year and through the quarterly performance report, which includes:

1. Fund summary describing the structure strategy and relevant news.
2. Executive summary detailing funds, investments, and changes related to fund managers.
3. The trend of a monthly IRR and the actual value of the sum invested.
4. Important news about the target companies.

As already stated in the previous chapter, many funds rely on an advisory board and an investor's committee. The advisory board solves potential conflicts of interest and supports the managers, whereas the investors committee takes care of the relationship with the key investors. It is advantageous to avoid an excess of involvement in the daily operations without the delegation of audit and planning authority.

Therefore, it is impossible to conclude the analysis of the first fundraising step without considering the costs connected with the creation of the deal in terms of time spent, economic resources and due diligence. Preparation of the business idea involves a legal audit of the fund structure and the predisposition of a marketing presentation. The most expensive part of building a new private equity fund is driven by the costs of legal and fiscal advisors.

In addition, a private equity firm needs also to take into account additional costs due to promotion fees paid to the placement agent. The placement agent is a specialized operator with a big network of potential capital-rising clients whose experience contributes to the definition of the fund and the marketing strategy. Therefore, the GP hires the placement agent to facilitate a quick fundraising process and attract a more effective segment of investors. The placement agent is paid a significant commission, about 2% of capital raised, applied only in case of success.

In Europe is common to form a sponsorship with banks and consulting companies with well-known and extensive reputations. Sponsors of the fund are selected because of their professional track record and success with previous deals.

It is also important to underline the importance of investment managers who manage and maintain the relationship with the potential investors. They organize several periodic meetings to inform the potential investors about the fund. GP must also manage and develop a relationship with financial markets. This element is of paramount importance for the entrance and maintenance of the fund's position inside the financial market and for the future successful fundraising.

The due diligence process allows investors to acquire all the necessary information to make the investment and guarantee fast closing. When due diligence is done properly, it focuses on the market, environment, financial structure, and legal and tax position of the company financed.

We can identify the second step of fundraising activity with the name "Job Selling", in which it is crucial to identify the category of investors potentially interested in a fund. The fundraising strategy is profoundly influenced if the fund is new, or if it represents the continuation of a previous initiative; the absence of a track record and the necessity to develop a network of contacts makes the fundraising complex and laborious.

After deciding the channel and the parties to be employed to raise funds, the following step is to identify the target market and develop the fundraising strategy. To raise funds, domestic investors should be consulted first, as their confidence in a specific fund attracts foreign capital, who take into account the economic prospects of the fund's country, its capital markets, the presence of interesting entrepreneurial initiatives, etc.

The size of the fund becomes conspicuous if large institutional investors are involved. When selecting potential clients, it is also necessary to note the increasing role played by gatekeepers (institutional investors offering consulting management or services). Originating in the United States, but now diffused also in Europe, gatekeepers raise funds from small- or medium-sized institutions, large institutions without experts in the private equity sector, or high net worth individuals who wish to invest in private equity initiatives.

The premarketing phase focuses on understanding the potential market in order to evaluate interest and gather useful information for the investment proposal. This usually occurs through meetings to update existing investors about new possible initiatives. A purely informative meeting such as an international roadshow will be organized with new potential investors. Managers must be prepared to give precise information relating to the track record of past initiatives specifying details relative to the structure of the operation, cash flow generation, the growth of the investments, and timing of exit. Once the fund has market approval, its structure must be defined in cooperation with legal and fiscal advisors. The project must remove any legal, fiscal, and technical factors that could discourage investors.

To conclude this step, the private equity firm needs to prepare and send the legal documentation to the probable adhering investors (partnerships agreements, copy of contract, fiscal and legal matters, etc.); the operation will be closed once the final adherents are notified.

In the case of leveraged buy-outs, a crucial aspect on which to focus on the fundraising phase is the financial structure of the private equity deal, as the profitability of the investment is strictly connected to the value created by debt leverage. The optimal capital structure is a range of D/E that ensures tax shield benefits and avoids any risk connected with distressed financial structure.

Debt can be divided into different categories depending on two main elements: seniority and operational issue financed.

Senior debt is the main part of the debt in a private equity deal that ensures the investor will be repaid before any other creditor. If senior debt does not cover the entire acquisition price or the promoter wants to reduce the level of equity, it is possible to be financed with junior debt, which has a lower level of guarantee but higher level of interest. If these debts are traded on a public market, without collateral, they are called high yield bonds. This category of debt will be settled only after the total repayment of the senior facilities.

Halfway between equity and debt is mezzanine debt. This is a sophisticated financing instrument, which is covered by the same senior collateral, and its reimbursement always happens between the senior and the junior debts. The servicing of mezzanine debt is broken down into three different types: interest paid yearly, structured with a capitalization system with payment at the end of the loan, and represented by equity linked to company performance.

The point of arrival of the fundraising phase is represented by Closing. This phase can be meant in two ways:

- A "successful" closing occurs when the private equity firm is able to collect all the money necessary to begin the activity. A successful closing can occur, and this was possible thanks to the reputation and to the purpose of the initiative.
- A "pure" closing occurs when the PE firm is not able to collect the whole money in the fundraising phase. Such is the case when the managers of the fund do not have a very robust network.

Despite having stated, in the limited partnership agreement, the target timing after which the private equity will start to operate, some funds have the so-called "first close". This means that whenever a certain threshold of funds has been raised, managers can begin scouting companies and making investments. However, they still leave the funds open for further LPs for a limited period until they reach the final closing date.

Trends and evolution of fundraising activity in the Italian Market

After having explained in detail the fundraising activity, as the initial and therefore crucial step of the private equity process, it is necessary to investigate what are the main trends regarding the source of the capital raised in Italy, in order to have a complete picture on the size and impact of the market, also in comparison with the European one.

The first graph, represented below, shows the sources of capital raised in Italy between 2019 and 2020.

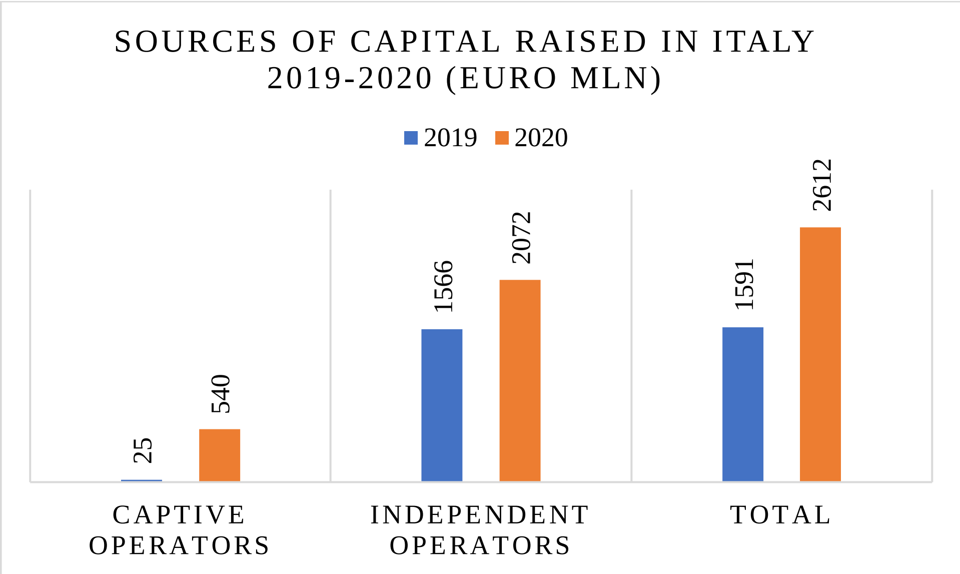

Chart 10. Source: AIFI 2019-2020 Il mercato italiano del private equity, venture capital e private debt.

Captive operators are defined as operators in private equity owned for a majority stake by a financial or industrial institution, which defines its strategic and operational lines, and provides it with the necessary capital for the investment activity. In contrast, we find independent operators, with a specific investment focus on the Italian market.

From the chart 10, we can observe how the collection of capital has increased significantly between 2019 and 2020. The raising of capital on the Italian and international financial markets by independent operators amounted to 2.072 million euros, an increase of 32% compared to the previous year (1.566 million euros). The capital raised by captive operators has also grown significantly from 25 to 540 million euros.

It should be noted that, according to international methodology, the fundraising data, represented in chart 1, do not consider the resources attributable to international operators with a stable base in Italy, thus underestimating the overall value of the resources available on the market. In the event that the capital invested by the latter, during 2019 and 2020, were assumed as proper fundraising, the total amount of capital flowed into Italy would be respectively 3.431 and 5.728 million euros. Furthermore, it should be noted that the analysis does not include the capital raised by retail funds for which it is not possible to identify the portion destined for direct private equity and venture capital investments.[39]

In the second chart proposed, the evolution of the origin of capital raised on the market by type of source is shown, between 2019 and 2020.

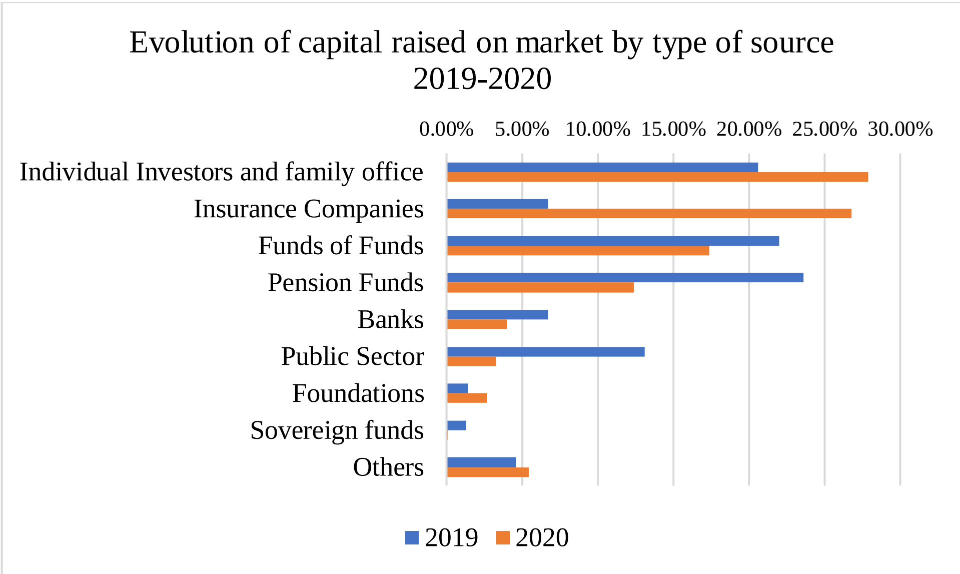

Chart 11. Source: AIFI 2020 Il mercato italiano del private equity, venture capital e private debt.

Chart 11 represents the fundraising analysis by type of source. It shows that individual investors and family offices represented, in 2020, the first source of capital (28%), increased compared to 2019, thanks to the closing of some retail funds. The second source of capital are insurance companies (27%), involved in particular in the raising of a significantly large dimension fund.

Comparing the data reported by AIFI on fundraising activity in Italy with the data provided by Invest Europe, we note that, taking into consideration the European private equity market, pension funds represent, in 2020, the main source (29%) of capital raised by private equity funds. In the same year, individual investors and family offices represent 14% of capital raised, while insurance companies amount to 10%. The types of sources just mentioned, at a European level, have not undergone significant changes compared to the previous year (2019), as the percentage amount of pension funds

[39] AIFI, *Il mercato del private equity, venture capital e private debt*, 2020.

has not changed, individuals and family offices have increased by one percentage point, and insurance companies decreased by one percentage point.[40]

It is therefore a fact that, in 2020, pension funds represent almost a third of the capital raised within the private equity industry, more than double in relative terms compared to the Italian market. The most powerful rationale for pension funds to invest in private equity is its ability to provide good returns on an absolute and relative basis.

iii. Investing Activity

Once the fundraising phase is complete, the next objective is focused on how to utilize the accumulated resources. This objective kicks off another phase of the private equity cycle, the investing activity.

Investing is the core of private equity business and the way to develop a business idea for the investor. There are two main initial steps in the investing activity[1]:

- *Decision Making*: valuation and selection of opportunities and matching them with the appropriate investment vehicle. Target company valuation, the “core performance” of a private equity fund, is a proper blend of strategic analysis (about the business, the market, and the competitive advantage), business planning, financial forecasting, human resources, and entrepreneur and management team assessment.
- *Deal Making*: activity of negotiation of the contracts by which the private equity firm can invest and actively participate in the company. These contracts include, for instance, the calculation of the shares the investor has to buy and the corporate governance rules.

Investments’ selection as made by the investor is a complex process because there is information asymmetry based on the interaction between impartial components, analyses with strong methodological rigor, and subjective experience and intuition.

The first valuation step is the pre-investment phase, where a series of critical factors are defined to evaluate if and how they affect the investor.

The decision-making activity is often based on two different forces[41]:

[40] Invest Europe, *Investing in Europe: private equity activity 2019 & 2020*.
[41] S. Caselli, G. Negri, *Private Equity and Venture Capital in Europe: Markets, Techniques, and deals*, Elsevier, 2021.

- *Pull-based origination*, as part of the origination is spontaneous. As a matter of fact, the whole financial business community is aware of the fact that the investor has just started the research for a target company in which to invest. The financial community, at the same time, knows that the investor is looking for a target company with high liquidity and availability. This will generate for the private equity investor a vast selection of potential projects in which to invest.
- *Push-based origination*. On the other hand, origination is based on a proactive activity, which can be carried on also with the help of other players involved in the fund. The private equity firm have to scout the market and find the most suitable solution for their investment portfolio.

Once the first panel of projects is identified, the screening activity is strongly influenced by the strategic orientation of the investor and the characteristics of the fund. For example, the geographic location, the sector, and the type of product.

The core of the decision-making process is concentrated on several key steps where the investor has to study and assess the business plan of the target company.

At the company level, the project scheme is defined as business plan; it is the first way to establish a relation between entrepreneur and institutional investors to create a virtuous circle of trust as well as a request for risk capital.

As a result of this, the management of the target company prepares the business plan very carefully, communicating any relevant information that makes the project unique, profitable, and appealing. An exhaustive business plan includes an executive summary that examines the core elements of the project: opportunities, risks, expertise of the management team, and timing.

The first element that the business plan must define is the product/service and its characteristics. Particular emphasis must be placed on the intrinsic novelties of the product, without neglecting the technical details and explaining them where necessary.

After that, a crucial step is to describe the market in which the target company operates, from a macroeconomic point of view. It is therefore necessary to define the global dimension of the market in which the product/service will be sold and to describe the growth rate of this market, whether existing or potential. Beyond this it is also important that the market is analyzed at its lowest or “micro” level, in order to identify the appropriate distribution channels and targeted professional strategies. Moreover, a description of the players and forces that make up the competitive arena is necessary, according to the classic model of the five Porter forces.

Among all other things, the business plan must contain relevant information such as production aspects, operational plans and economic-financial data, the financial structure of the target company and the divestment strategy. Once the business plan has been carefully analyzed and evaluated, the private equity firm must decide whether or not to enter the investment.

Investment decisions are made based on several factors: the current and potential market shares of the company, its technology, and the creation of value during the exit phase. The negotiations step generally last between 3 and 6 months after the preparation of the business plan, depending on the clarity and completeness of the information supplied by the entrepreneur. This information also defines the price and timing and method of payment.

If there is an agreement on the key points of the deal, the parties sign a letter of intent in which the economic and legal aspects of the operation are defined and that will be refined in the investment contract.

Once the negotiation step has been carried over as well, the managers of the fund have to convince the whole board of the private equity firm that it is worth to invest in that specific company. The decision of investing does not mean to invest immediately in the company, rather it sets the beginning of the second part of the investing phase, deal-making or contract designing.[42]

In the deal-making phase, a fundamental aspect is represented by the definition of the price and, therefore, by the evaluation of the company. In the context of private equity or venture capital transactions, the valuation is never theoretical or abstract, but always linked to a price, real and effective, which is what will constitute the basis of exchange in the transaction itself.

The target company, therefore, rather than being evaluated is "priced", and consequently in the final result not only decisive qualitative aspects will come into play but also, the free negotiation between the parties and the relative contractual strength of each of them.[43]

As already stated, the deal-making phase concern with the terms of the agreement regarding pricing, quota of participation and administrative aspects, between the company, its shareholders, and the investor. The relation between the private equity-backed company and the investor is regulated by the term sheet, which is a document that outlines key financial aspects, such as the number and category of shares to be bought and their price, as well as a list of terms for a proposed investment.

[42] S. Caselli, G. Negri, *Private Equity and Venture Capital in Europe: Markets, Techniques, and deals*, Elsevier, 2021.

[43] A. Gervasoni, F. Sattin, *Private Equity e Venture Capital: manuale d'investimento nel capitale di rischio*, Guerini Next, 2020.

The first task to be carried out is the targeting of the right vehicle; the valuation of the alternative investment or company or a special purpose vehicle (SPV) set up just for the deal.

The liability profile of an investment vehicle should also be considered in the deal making. As already explained in the previous paragraph, debt issuing can be realized through banking loans or bonds placement, and the most common scheme is an investment in an SPV through a leveraged buy-out to acquire a target company. There are two financing tools available for this scheme:

- *Syndication strategy*: the promoter finds other equity investors and builds a syndicate. This tool is recommended because it increases investment power while sharing risk.
- *Debt issuance*: the decision to combine equity investment (with or without SPV, syndicated or not) with leverage. The decision of using leverage allows to multiply the impact of equity investment, in terms of value, provided that the higher financial risk is sustainable. Bond placement can be done also through a syndication between different banks.

The last aspect to be considered in the deal making is the engagement. It begins by choosing categories of shares or share class that can guarantee the best way to support the investment. Typically, the private equity investor chooses between a range of shares with different rights and duties: common shares, preferred stock, shares with embedded option, tracking stock, etc.[44]

A crucial investment choice to be made during the engagement step is connected with the paying policy, the technique of issuing shares and the relationship of management within the company's corporate governance.

The last step included in the engagement process are the governance rules, the general agreement on shareholders duties and rights, Board of Directors activity, and information flow. Governance rules can be formally written in the Limited Partnership Agreement, in the internal code of activity, or in a formal autonomous agreement designed to discipline the power of shareholders.

Once the two initial phases of the investment process are concluded and the investment agreement has been reached, a fundamental aspect of the investment phase concerns its monitoring and valorization.

At this point, before proceeding with the analysis of the activities in support of business enhancement by private equity operators, it is important to deal with the issue of monitoring and defining the governance of the investee company.

[44] A. Meles, *Private Equity e sviluppo dell'impresa. Analisi teorica e indagini empiriche*, Franco Angeli, 2013.

It is in fact necessary and critical for the private equity operator, and in some cases a factor of effective value creation mechanism, to ensure the adoption of clear and advanced governance rules, as well as management control systems.

From the very beginning of economic theory, the research activity has underlined how the separation between ownership and management essentially generates two major issues: the divergence of interest between the subjects involved and the information asymmetry generated by the division of their roles. Therefore, it appears evident that shareholders and managers, having a peculiar and very different role between them within the corporate structure, have potentially very different objectives and time horizons.

It should therefore be emphasized that, in order to preserve a healthy development of the business reality, it cannot be sufficient to achieve a sharing of intentions and strategic objectives, but it is necessary that the top management members also participate in the business risk through their own economic remuneration.

In practice, all this translates into the use of management packages built in order to involve:

- A fair balance between fixed and variable remuneration, by virtue of the characteristics of the business and the risks of the company and its sector.
- Predetermined, measurable performance objectives linked in a significant part to a long-term horizon, on which the payment of variable remuneration components is also based.
- The use of more complex equity instruments, such as long-term incentive plans, stock options or phantom stock option agreements, options, exit ratchets agreement and many others. Also in this case, an adequate time frame should be provided for the implementation and exercise of the agreements, again in order to be able to achieve a long-term goal.
- Clear and predetermined rules for the disbursement of any indemnity for termination of the relationship in the event that the interruption does not result from the failure to achieve the objectives. These rules define the maximum limit of the total amount payable by the company and any responsibilities of the management.

The "fil rouge" of all these points is, in fact, the desire to align the interests of executive directors and top management with those of shareholders, envisaging long-term performance objectives, presumably more solid and sustainable over time.

The more closely interests align between owners and managers leads to the implementation of restructuring activities aimed at improving a firm's efficiency through a better long-term control of costs. The disciplining role of debt prevents managers from wasting resources, for example by investing free cash flows in projects with negative net present values. It follows that agency theory contends that buy-outs result in a superior governance model that, in turn, leads to improved firm performance.[45]

In order to increase the value of target companies, private equity exploits different strategies in order to get the highest value possible when exiting their investment. Strategies should be considered with the positioning of the fund declared in the fundraising phase. These strategies changed considerably in the last decades, and they are driven by the macroeconomic expansion or recession and by capital markets trends. It is possible to identify at least four strategies, where the adoption of one strategy does not exclude the adoption of other ones.

If the private equity backed company wants to consolidate the position in the market and establish a large industrial group, integrated either at a horizontal or vertical level, it may be necessary to acquire several companies. A buy-and-build strategy consists in a bigger company that acts as a "platform" company, which buying out smaller companies grows significantly. This strategy is usually done by a mature company, where the private equity fund holds a majority stake, hence it is possible to find this kind of deals among the buy-out deals. Like the name itself evokes, the purpose in this kind of deals is to buy a target company, merge it into the platform company and consolidate its position in the market. Buy-and-build strategies are also called "bolt-on" acquisitions.

There may be several advantages in a bolt-on acquisition. First of all, the platform company can scale up more rapidly. This particularly convenient for those industries where entities are high-entry barriers. Secondly, thanks to a bigger size, the group is able to operate more efficiently and enjoy economies of scale. The bigger the size of the private equity backed company and the more efficient the operations, the larger the margins and its solvency, hence the potential exit price.

Despite those benefits, bolt-on acquisitions do not come challenge-free. As a matter of fact, M&A operations may be very expensive, hence, further debt may be required and every time that there is an acquisition, the target company must be integrated and there is always the risk that, in the post-merger, synergies are not created due to the lack of integration.

The second strategy used by private equity investors is related to financial leverage. As seen previously, the use of financial advantage leads to the increase of the value of the company thanks to its tax shield. After a careful rating assessment, the private equity investor may decide to increase the debt of the target company, as this increases the liquidity and, therefore, the possibilities of the

[45] G. Scellato, E. Ughetto, *Real Effects of private equity investments: Evidence from European buyouts*, Journal of Business Research 66, 2642-2649, 2013.

company. This strategy implies that the VBC generates a strong and stable cash flow to settle the financial debt.

Private equity can also create value through some actions targeting the revenues. In order to maximize the revenues, General Partners may lead the portfolio company to develop new products, expand geographically, increase prices, or enhance sales force effectiveness. Operating improvement is mainly concentrated on increasing revenuers, but it is not surely the only target. Operational improvement also aims at reducing the operating costs and selling, general, and administrative expenses. This is a strategy commonly adopted in buy-and-build where the size and the economies of scale are the main purpose of the deal. Regardless, it may be implemented in other kind of operations, like those of the growth capital deals, where it often happens that private equity backed companies open several points of sale and shops in order to maximize the revenues.

The last viable strategy is the multiple arbitrage strategy. When fund managers want to exploit the multiple arbitrage or expansion, it means that they want to enhance the market value of the target company by selling not only the company per se, but also its potential leveraging, for instance, on the company's strategy and forecast, thus lowering its risk profile. The aim of this strategy is to make the multiple paid by the buying part at the exit as high as possible. However, valuations are also subject to external factors, such as market conditions and the macroeconomic environment. So, this strategy is clearly subject to market trends and cannot be the only way in which a private equity generates value.

Trends and evolution of Investment Activity in the Italian Market

At the end of this paragraph, it is necessary to give a perspective on the trends and statistics regarding investment activity in Italy (specifically considering a time frame of 5 years), with regard to the breakdown of investments by type of operation, the profile of the invested companies, and the breakdown of investments by geographical origin of the operator.

In the first two charts, displayed below, is represented the evolution of investments by geographic origins of the private equity operator, involving a comparison of the percentage of the number of investments and the amount invested in 2019 and 2020.

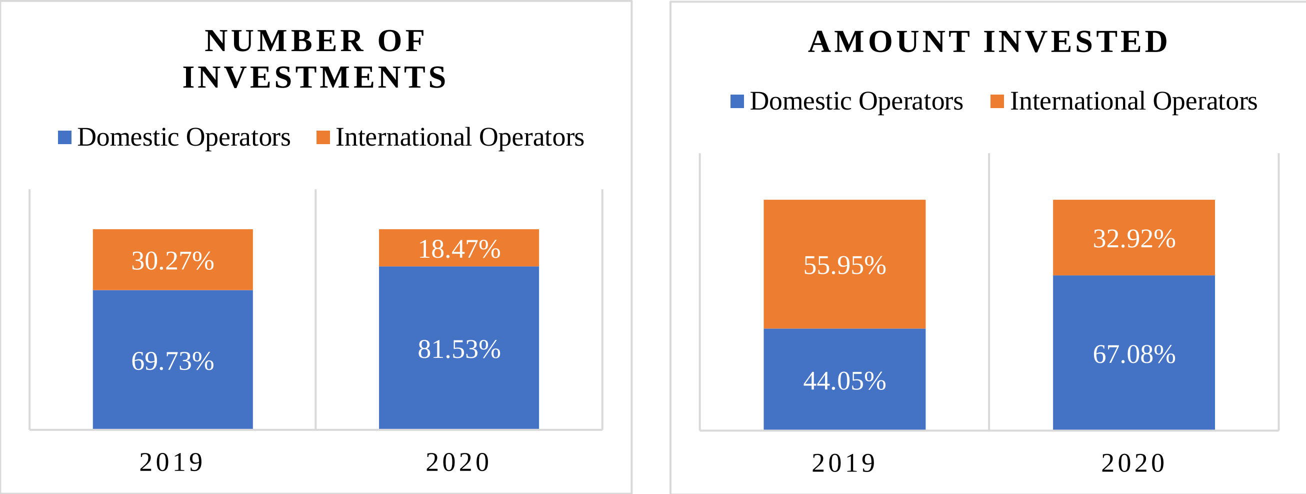

Chart 12 & 13, AIFI 2020, Il mercato italiano del private equity, venture capital e private debt.

As we can see, regarding the activity carried out by the various categories of subjects, international operators have absorbed 67% of the market in terms of amount invested in 2020, equal to 4.425 million euros, while domestic operators have invested the remaining 33% (2.172 million euros). It should be noted that international operators without an office in Italy have invested 1,308 million euros in the country, distributed over 38 transactions. In terms of number, domestic operators made most of the investments (384, equal to 82% of the market). As a result, although domestic operators make a significantly higher number of investments, the amount of money invested is approximately 1/3 of that of investments from international operators.[46]

A crucial aspect to analyze, also in view of the final empirical analysis, is the distribution and trend of the amount of money invested by private equity operators by type of transactions, which, as we have already seen, are growth capital, buy-out, turnaround and replacement. For this purpose, in the following table, will be reported data concerning the amount invested in the last 5 years for each type of operation.

Trend of amount invested in different investment typologies (Euro mln.)				
	Growth Capital	*Turnaround*	*Replacement*	*Buy-Out*
2016	710	66	597	5.772
2017	338	111	253	3.444
2018	816	123	242	5.242
2019	896	96	355	5.096
2020	354	172	1	4.370

Table 2, AIFI 2020, Il mercato italiano del private equity, venture capital e private debt.

[46] AIFI, *Il mercato italiano del private equity, venture capital e private debt*, 2020.

During 2020, 354 million euros were invested in the growth capital segment, spread over 40 operations. Compared to the previous year, the figures have decreased by 61% in terms of amount and 17% in terms of number. In detail, from the analysis of the type of investors active in the segment, it emerges that those domestic entities have made the largest number of investments (83%, 71% in terms of amount).

The turnaround segment also maintained a niche role in 2020, with the realization of 9 investments against 7 in 2019, while the amount went from 96 to 172 million euros.

The resources invested in the replacement sector amounted to just over one million euros (355 million in 2019), distributed over 2 investments, compared to 11 the previous year.

Finally, the buy-out segment attracted 66% of the total capital invested in 2020, equal to 4.370 million euros (down by 14% compared to the previous year) and is undoubtedly the most widespread segment among private investments. equity. In detail, there were 94 transactions (123 in 2019), with a decrease of 24%.

At the end of the paragraph dedicated to private equity investments, I considered it appropriate to investigate in detail the main two types of investments in Italy, buy-out and growth capital operations, in particular by deepening and comparing the main information resulting from the profiles of the target companies (sector, revenues and employees) provided by the Private Equity Monitor, always taking into consideration the last 5 years (2016-2020).

The chart 13, displayed below, shows the distribution of the number, in percentage, of buy-out transactions compared to growth capital transactions divided by sector in which private equity operators invested in the last 5 years.

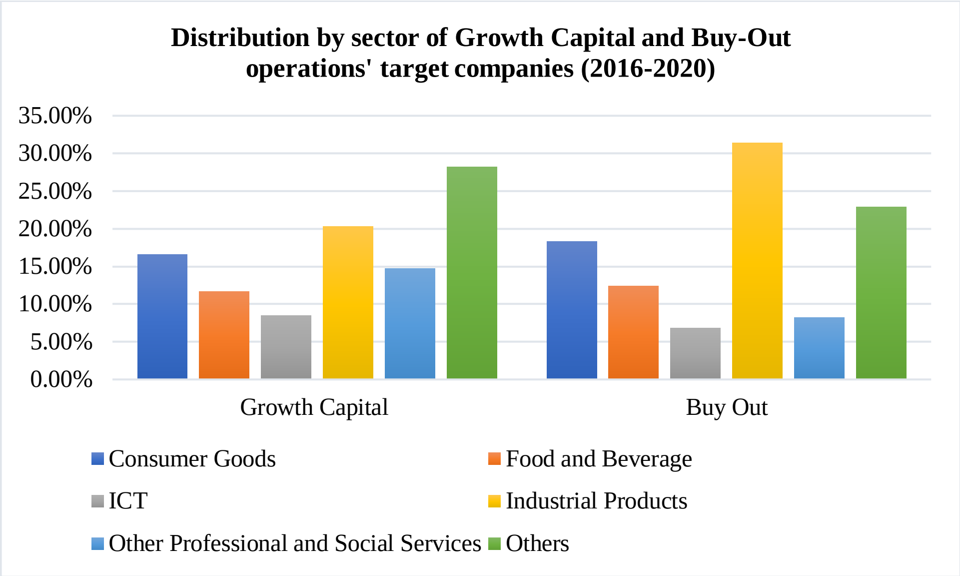

Chart 13. Source: self-elaboration 2021, data provided by Private Equity Monitor 2016-2020.

As we can see from chart 3, for both segments the most widespread investment sector is that of industrial products (20,30% for growth capital and 31,40% for buy-out), followed by the consumer goods and food and beverage sectors.

In the following graph, chart 14, a similar distribution to the previous one is represented, however, concerning the number of employees.

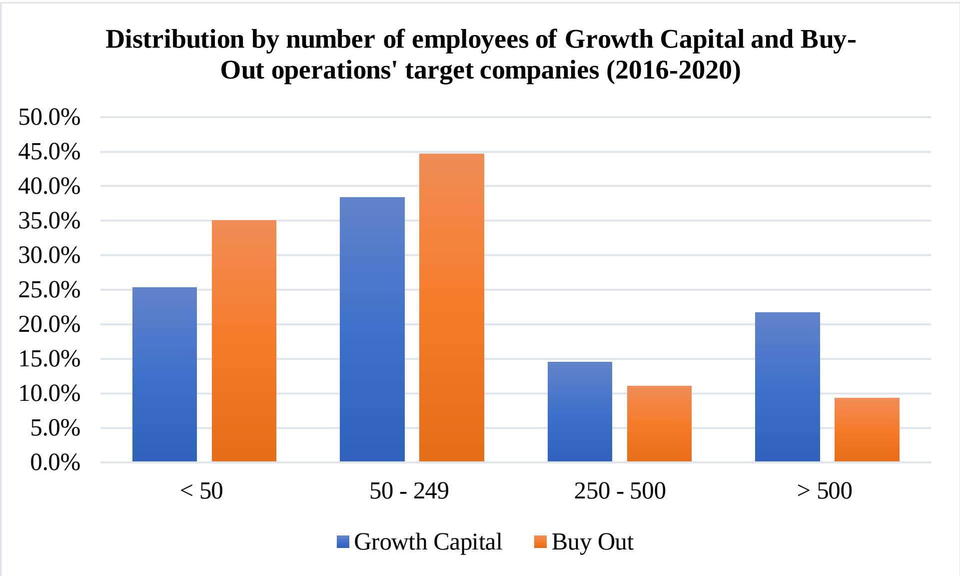

Chart 14. Source: self-elaboration 2021, data provided by Private Equity Monitor 2016-2020.

Also in this case, the target companies invested using buy-out and growth capital operations follow a similar trend, in fact for both types the greatest number of investments were made on companies with a number of employees between 50 and 249. From this graph we can also see that, for both types, a greater number of operations are carried out on companies with less than 250 employees.

To conclude, the last graphic, chart 15, proposes a similar comparison made on the revenues of target companies, also divided into bands.

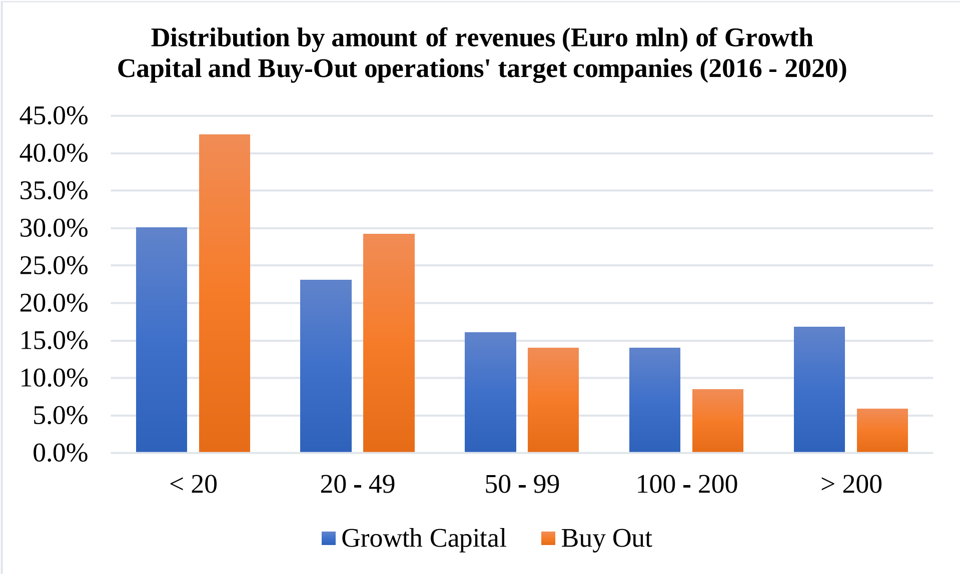

Chart 15. Source: self-elaboration 2021, data provided by Private Equity Monitor 2016-2020.

Analyzing chart 15, it is possible to state that for buy-out operations, in the last 5 years in Italy, the main target has been companies with than 50 million euros revenues, with approximately 71% of total investments. As regards growth capital operations, the distribution is definitely more homogeneous, although also in this case the companies having less revenues than 50 million euros represent the target of reference, the companies with more than 100 million euros revenues still represent the 31% of the total, as opposed to 14% of buy-out.

iv. Exiting Activity

The exit phase is a fundamental step for the private equity investor, as only through it does the monetization of the creation of value implemented during the investment period take place. Through divestment, the creation of value becomes from theoretical to effective, transforming the portfolio valuation into a price and consequently into a yield obtained on the market. For this reason, from the first analysis of the potential investment, private equity operators question themselves in advance about the exit possibilities and the most likely categories of potential acquirers at the time of divestment, despite being very distant in time.

During the investment cycle, the prospect of exit cannot be neglected, in particular when the company must evaluate a transformational acquisition that could positively or negatively affect the success or the exit. Think of how profitable it is, for the purposes of a subsequent valorization, to have increased the scale of the company and its degree of internationalization through a build-up strategy and have placed it in a range of higher multiples.

For the purpose of maximizing the capital gain inherent in the shareholding, the critical factors in the exit phase are essentially three:

- The choice of the time window to implement the divestment, which depends both on the performance of the company in the portfolio and on the conditions of the M&A and capital markets.
- Identification of the category of potential buyers (strategic and financial or public equity market). This choice will influence the adoption of the divestment process, which may result in an M&A or IPO path.
- The decision on the sale strategy to best enhance the outgoing asset.

As already mentioned, exit planning should start early, with considerable thought being given to structuring and positioning the business to make it attractive to likely buyers, as well as networking and relationship development with these buyers. A lot of preparation should go into the robustness of the management plans, the detail of due diligence, and other reports. Efforts should be made to "warp up" the market, by making potential buyers aware of the upcoming sale several months before the formal process starts.

The exit thesis normally forms a key part of the investment approach for any investment contemplated by the private equity firm. GPs need to understand the exit potential of the underlying business to recognize any elements of the proposed investment strategy that may actually detract from value creation.[47]

When deciding whether to exit or keep the company in portfolio for a longer period, a private equity firm should consider several strategic factors. Most likely, a successful exit strategy balances the company's need for additional growth capital with the need to provide returns on capital to the fund's LPs. The possibility of obtaining a capital gain depends primarily on the performance of the company in the portfolio. The divestment decision is taken when the investment, thanks to its operating and financial results, allows for a return deemed attractive by the managers. The decision to divest, unless it is "forced" by the need to liquidate the investment quickly due to maturity of the terms of the fund, occurs at the end of a growth path. It therefore occurs when the three factors of value creation, the growth of operating profitability, deleverage and the potential arbitrage on multiples, allow a level of

[47] S. Caselli, G. Negri, *Private Equity and Venture Capital in Europe: Markets, Techniques, and deals*, Elsevier, 2021.

capital gain considered attractive. In addition to the historical series of economic and financial data, great attention must be paid to the trend of current trading, i.e., the performance of the company in the months in which the sale procedure will take place, both of the M&A or IPO, and its alignment with the budget of the current year.

It is important to grasp whether the target firm is able to manage throughout the exit process by itself. Realization of an exit strategy may involve a relevant amount of time and money to pay for advisors, especially during an IPO process. Before conducting an exit strategy, a company will be subject to a stringent due diligence process to ensure that all of the proper systems and controls are in place. A company is in a position of strength if its track record shows it consistently outperforms performance targets.[48]

A fundamental element to consider while choosing the right moment to implement the divestment is the condition of the markets, both for M&A and stock exchanges, and last but not least, for acquisition financing. In difficult market situations (i.e, a crisis or a so-called "black swan"), the mortality of deals increases exponentially, and there is a rapid downward pressure on prices, resulting in a gap between buyer and seller. Also, the IPO market is heavily affected by the shocks, with a mortality that occurs very quickly and with a flow of new stakes that is interrupted and that can remain at zero for months.

The investor who is preparing his exit path must foresee the conditions of the markets with a few months in advance, and not base the choice of the exit timing only on the growth of company performance. In the presence of a crisis on the markets, the reaction of the buyers is very rapid and can even endanger the deals between the signing and closing phases, if there are stringent clauses of material adverse change or "subject to financing" in the contract. In addition, deals for which a sales contract has not yet been signed may suffer a decrease in transfer prices, extended due diligence times and a high risk of abortion of the deal as a whole.

In the selling procedure, starting from the choice of the right moment, the active collaboration of all partners, in particular, those operating in the company, is necessary. Asymmetrical and uncoordinated behavior and interference in the sale procedure can create disruption and jeopardize the entire process. The need for alignment and responsible attitude must naturally also be extended to advisors, in particular to the investment bank responsible for the process, called upon to provide a reliable

[48] E. Talmor, F. Vasvari, *International Private Equity*, Wiley, 2011.

estimate of the future sale value and to suggest the most appropriate time window, avoiding any conflict of interest.

Once the favorable exit period has been chosen, there is the need to choose the appropriate divestment channel, i.e., the type of potential buyers to turn to. For our purposes, we can identify four categories of interlocutors: strategic buyers, financial buyers, the stock market, and the original shareholders (buy back).

Strategic buyers are groups active in the same sector as the target company, or in contiguous or similar sectors. Strategic buyers can operate in a diversification logic, even if the tendency to create conglomerates has faded in recent years. Theoretically they are the only ones who can benefit from operational synergies and in some sectors and historical moments they manage to pay consistent premium prices compared to other interlocutors. This disinvestment channel is defined as trade sale and is, for majority or totalitarian transactions, the most frequent at international level, even if with different weights from country to country.

Unlike the secondary buy-out, which we will see later, this option almost never grants the private equity investor the possibility of a partial divestment and possible maintenance of an upside, given the buyer's integration and rationalization needs and the absolutely different objectives between the two categories of investors. It should be remembered that for a management recovering from a successful buy-out, the trade sale, especially if towards a direct competitor, it could be the less welcome solution, and the exit procedure could be conditioned, with a probable deployment of management in favor of other buyers.

The sale of minority packages, in the absence of a shareholder who at the same time alienates a stake that allows a majority to be obtained, instead, sees strategic buyers as less likely candidates, due to the reduced possibility of integration and rationalization synergies.
Exceptions can be justified only for investments in companies that have an extremely interesting commercial or technological profile, and that bring to the trade buyer synergies of well-defined revenues or technological advantages.

Financial buyers, on the other hand, represent a very broad category, ranging from traditional private equity funds to permanent capital operators, up to including family offices and investor clubs. This operation is commonly referred to as a "secondary buy-out" and in recent years has seen a progressive development in all advanced markets, also due to the growing endowments of private equity funds and an ever-wider, liquid, and competitive acquisition financing market.

This exit channel, which is the second most important at a valorization level, strongly depends on the availability of leverage financing, as well as on the company's ability to generate a further upside in terms of organic growth and build up. The secondary buy-out occurs more and more frequently also in serial form, with subsequent "tertiary" and even "quaternary" buy-out operations. Often, in these share transfers between investors, the company finds itself in a full path of development, and thanks to its growing scale and degree of internationalization it enters a higher category.

The exit through secondary buy-out can have the advantage of allowing a partial reinvestment by the seller, who, alongside the incoming shareholder, will be able to benefit from a subsequent and further creation of value. The alignment of interests, given the homogeneity of the investors, can be easier. By secondary buy-out, in a strict sense, we mean the share transfer between financial institutions of the majority of the capital with a mixed intervention of equity and debt by the buyer.

The sale of a minority package, on the other hand, is more properly defined, as we have already seen, as replacement capital. Also, for this type there is a growing market in almost all advanced countries, above all thanks to the presence of a greater number of subjects specialized in minority transactions, in particular permanent capital operators, not bound by particular deadlines as in the case of traditional private equity funds.

The repurchase of the shareholding by the original shareholder who remained in the company's capital is commonly referred to as a buy back. It is undoubtedly a more frequent case in the exit of minority investments and at least initially it remains, compared to the others, a residual way-out option for the investor who has the primary objective of creating value through a transaction with third parties. This exit channel in terms of importance stands in fourth place, with a greater frequency in the venture capital and expansion capital sector than in pure management buyout. The repurchase in fact recreates the ante status with respect to the original investment operation and becomes an obligatory channel when the other exit options are not feasible or are not appreciated by the majority shareholder.

The repurchase can take place both on the basis of a put and call clause stipulated at the time of the investment and through an ad hoc M&A negotiation in the exit phase.

In cases where the recipient of the sale belongs to the categories of strategic buyers and financial buyers mentioned above, and also, albeit in a very shortened form, in the case of the buy back, the divestment process is that of M&A operations. This procedure, although not regulated from a regulatory point of view unlike the IPO that will be mentioned below, is articulated and complex and usually requires a large number of subjects involved and several months of work.

This is because the phases of preparation of an information base, the drafting of a partner list, the first approaches to the market and the deepening of knowledge of the project by potential buyers, the presentation of offers and subsequent due diligence, up to the negotiation and signing of the sales contract. And the process ends only on the closing date, with the endorsement of the shares or quotas and the simultaneous transfer of funds, once all the necessary authorizations have been obtained.

If the exit strategy involves an IPO, the stock market is the buyer of the fund's holding. The IPOs put in place by private equity entities certainly have an advantage in terms of certification effect, knowledge of the markets and credibility of the assignors, but they are also subject to the contingent conditions of the capital markets and do not present the same degree of attractiveness and feasibility.

This sales channel requires specific qualitative characteristics (for example organization, transparency, reporting and dialogue with the market) from the companies that are going to be listed, as well as quantitative characteristics such as size, profit margins and income prospects. From a geographical point of view, it is emphasized that they are more frequent, as exits of financial investors, in Anglo-Saxon markets than in southern Europe. Sometimes, especially in majority transactions, the IPO allows the selling financial investor only a partial divestment, with relative advantages and disadvantages. Among the advantages, those of retaining a part of the upside linked to the appreciation of the stock market. Among the disadvantages, those of postponing the monetization of a part of the investment, with the risk of not keeping the price obtained during the IPO.

This valorization opportunity for the exit of financial investors, the IPO remains, in order of importance, only the third option after the trade sale and the secondary buy-out, both for the eligibility requirements that only a minority of the companies in the portfolio can represent and for the frequent objective of the transferors to implement a total disinvestment of the shareholding.

The IPO involves an absolutely different and more regulated process than the M&A, with lower degrees of flexibility, a series of standard features and a well-defined authorization process. The duration of the preparation phase varies greatly from company to company and at the end of it the target must present certain requirements in terms of governance, management control and adoption of accounting principles. It is known that many companies are more ready than others to face the stock market, and the decision of the private equity investor to implement an exit through IPO will depend on an objective diagnosis on the degree of the actual preparation and suitability of the company and of the management for landing on the markets.

In this regard, the possibility of implementing a dual track in which a listing process and an M&A process coexist is emphasized. The choice of the double track arises, in addition to the need to maximize the price, from the need to reduce the risk of execution and final pricing inherent in stock exchange listing projects, generally more exposed to exogenous factors and sudden changes in the market mood. Note how, although the processes are completely different in terms of structure and interlocutors, they can be reconciled from a timing point of view and benefit from each other, also because the huge processing of historical and prospective data carried out by the company creates in both cases a useful information base.

As a rule, the sequence takes place with the announcement and start of a listing project and then, in front of offers judged to be more attractive or signs of weakening of the stock market, resorting to the hypothesis of trade sale or secondary buy-out. The sequence can also be reversed, especially in the presence of broken auctions, after which, after a certain period of time, the IPO project is the priority option. In general, private equity investors, compared to corporates or family businesses, appear better prepared to manage a "double track", due to the familiarity and the consolidated track record in both markets.

Instead of the conventional IPO procedure, there is the possibility for the outgoing fund to go public through SPAC, an instrument aimed at facilitating and accelerating the listing of SMEs on the stock exchange. In this case, the listing takes place through a private M&A negotiation between the promoters of the listed vehicle and the shareholders of the target company. Once the business combination has been approved by the shareholders' meeting, the merger by incorporation will take place, after which the target company will acquire the status of listed. For the financial investor, the listing through SPAC of an investee company presents, compared to the conventional IPO, various advantages in terms of greater agility in the procedure, greater confidentiality in the preparation phases and greater certainty on the final exit price.

In conclusion, it is considered appropriate to mention two other forms of exit operations even if they do not consist in the sale of a shareholding. The first is the dividend recap, for which we mean the collection of dividends in an extraordinary form through the use of additional financial leverage, through a change in the capital structure, but not in the shareholding structure, an early monetization is made possible. The dividend recap is a valorization method strictly linked to the conditions of the leverage financing market and shows a marked cyclical nature, with substantial volumes during positive phases and vice versa almost absent in the phases of market contraction.

The write off of the investment, on the other hand, has opposite sign compared to the previous case. It is a total or partial reduction of the value of the equity owned by the financial investor. More than an exit method, it turns out to be a reduction in value with consequent capital sacrifice. Write off is also closely linked to the economic phase and tends to increase in times of crisis. However, even in the most difficult phases of the global economic and financial situation, it recorded an non-significant weight on the total investments in venture capital and private equity, also because the financial investor has often exploited the possibility of recapitalizing the company to avoid the hypothesis liquidation or bankruptcy and to negotiate an agreement with creditors at the same time.

Trends and evolution of exiting activity in the Italian market

According to the AIFI 2020 report, in the last 5 years, in Italy, the divestments number and amount divested has progressively decreased, as shown in the following table:

Evolution of divestment activity in Italy 2016-2020			
Year	*Number of divestments*	*Companies*	*Amount divested (Euro mln)*
2016	145	113	3.656
2017	202	160	3.752
2018	135	109	2.788
2019	132	108	2.216
2020	81	67	1.594

Table 3. Source: AIFI 2020, il mercato italiano del private equity, venture capital e private debt.

As reported by Table 3, in 2020, the divested amount, calculated at the purchase cost of the equity investments, reached 1.594 million euros, a decrease of 28% compared to the 2.216 million recorded the previous year. In terms of number, 81 disposals were recorded, also in this case a decrease compared to 2019 (132 exits), distributed over 67 companies. As regards to the breakdown of divestments into the types mentioned in the paragraph, the following two tables show the percentage distribution of the divested amount and the number of divestments by type in the years 2019-2020:

Evolution of percentage distribution of divested amount by divestment typology 2019-2020		
Divestment operation	*2019*	*2020*
Sale to other private equity operator	41%	55%
IPO / Trade Sale post-IPO / SPAC	20%	24%
Trade Sale	33%	15%
Sale to financial institutions / individuals / family offices	< 1%	1%
Buy Back / Other	4%	4%
Write Off	2%	1%

Table 4. Source: AIFI 2020, il mercato italiano del private equity, venture capital e private debt.

Evolution of percentage distribution of number of divestments by typology 2019-2020		
Divestment operation	*2019*	*2020*
Trade Sale	45%	43%
Sale to other private equity operator	20%	17%
IPO / Trade Sale post-IPO / SPAC	7%	15%
Sale to financial institutions / individuals / family offices	2%	2%
Buy Back / Other	21%	17%
Write Off	5%	6%

Table 5. Source: AIFI 2020, il mercato italiano del private equity, venture capital e private debt.

With regard to the selling methods of equity investments, in terms of amount (Table 4) the sale to another private equity participant represented the preferred divestment channel in 2020 (876 million euros), with an incidence of 55% followed by IPO / post IPO / SPAC sales, with a weight of 24% (383 million euros). It should be noted that both categories are characterized by some large divestments.

In terms of number, however, the most frequent type of exit remains the trade sale (Table 5), with 35 exits (43% of the total), followed by a sale to another private equity operator and Buy Back / Other (both with 14 divestments, 17% of the total). With specific reference to the type of investor, domestic operators were the most active in terms of the number of divestments (69% in terms of number of divestments), while in terms of divested amount, international operators prevailed (80%).

If we compare data concerning Italy with those made available by Invest Europe, in 2019 and 2020 reports on fundraising, investments and divestments, we note that there are no particularly significant differences.

In Europe, the sale to another private equity in operator also remains the most widespread type of exit, albeit to a lesser extent than in Italy (34% in 2019 and 35% in 2020). Also in Europe, in the second place, we find the Trade Sale which in 2019 amounted to 29%, lower than the 33% recorded in Italy, while in 2020 it amounted to 25%, higher than the 15% recorded in Italy, which suffered a relevant decline between the two years.[49]

[49] Invest Europe, S*tatistics on fundraising, investments, and divestments*, 2019-2020.

III. Chapter Three: Private Equity and Value Creation - review of previous research

i. How can Private Equity help target companies?

As frequently mentioned, the intervention of an institutional investor in the risk capital of a company is not limited to the contribution of new resources but may enable the company to enter into a new phase of its life cycle, influenced and supported by the collaboration with a professional interlocutor.

The issue of the role of investors, who are not only "capital providers", but real active owners who, working in support of the board and management of the company, contribute to the implementation of growth and value creation strategies, emerges centrally. As proof of the validity of this type of attitude, several studies have shown how investor activism can contribute to achieve higher performance than the market or the reference benchmark. But what exactly does this attitude of active ownership consist of? What are the corporate areas in which, by virtue of and respecting their role, the institutional investor can take part?

Taking into consideration also the generalist nature of private equity operators, ordinary business is normally left in the hands of the entrepreneur or the management team, as subjects who have all the elements and information to be able to manage their development.

Consequently, the area that most concerns the intervention of the operator is precisely the one with extraordinary nature characteristics, that is, strategic projects and operations that differ from normal company management. We should not forget that, regardless of any type of shareholding held, the investor's interest is necessarily aimed at the revaluation of the investment, and, for this reason, his intervention will always be aimed at achieving growth and development objectives.

Regarding this perspective, two considerations should be made. In the first place, turnaround transactions are normally an exception, as they represent situations in which the purpose of the investment is the restructuring of the ordinary operations of the company itself, and consequently, the intervention of the private equity operator must necessarily be more invasive. Secondly, each transaction is in fact a world of its own and the attitude of the investor shareholder must always be calibrated on the basis of the investment objectives and the relationship that exists with the company.

The areas which, according to the market practice and sector literature, are typically subject of intervention by private capital operators will be dealt with in detail below:

- Contribution of professional contacts and sounding board effect for the entrepreneurial idea.
- Support for the review of managerial processes and strategic framework.

- Support for internationalization, external growth, and creation of new business areas.
- Financial advice and services.
- Focus and investment in innovation, research, and development for greater production competitiveness.
- Support to the entrepreneur in dealing with managerial processes and possible generational transitions.
- Promotion of ESG practices.

Each investor brings with him his own wealth of experiences and contacts, which can constitute a very important opportunity for the company for discussion and reflection. It is about accessing a vision through the eyes of an "outsider", which gives the company the opportunity to analyze consolidated procedures and practices as opposed to the experience lived in other realities.

According to some studies, most companies very rarely compare their management habits with market practices and, as a result, they often simply do not realize the room for improvement they could work on.[50]

It is with this in mind that the investor can become a sort of "sparring partner" for the entrepreneur or for the management, acting both as a support and comfort interlocutor, and as a source of stimulus and "training" for the company in dealing with changes or actions of an extraordinary nature. Obviously, the situation is different when transactions such as buyouts are examined, where, de facto, the investor is the majority shareholder of the company and can therefore directly take positions on the managers and management methods of the company.

An element to be considered in relation to this specific contribution concerns the operator's previous experience, or whether the investor has a consolidated track record relating to the type of investment, or in-depth knowledge of the sector to which the investee company belongs.

The investment by a private capital operator is also an important "amplifier" for the company, that is a great opportunity for visibility by the industrial and financial community. This is because, in many respects, the investment is seen as a confirmation of the validity of the business model, as well as the growth prospects of the reference market. In other words, the trust placed by the operator in the company, the entrepreneur or the top management is certainly a good business card to be able to benefit from both in the relationship with other lenders, and with customers and other companies in

[50] N. Bloom, J. Van Reenen, R. Sadun, *Do Private Equity Owned Firms Have Better Management Practices?*, American Economic Review, May 2015.

the sector. This contribution proves even more crucial in turnaround investments, where the intervention and the contribution of external skills is normally the key to embarking on a successful corporate restructuring process.

In a competitive market and in a rapidly evolving context, it is essential to be able to make optimal decisions in a short time and with good forecasting skills. In this context, the comparison with the institutional investor and the contribution of skills, experiences and contacts are particularly beneficial to the company, as well as greater efficiency of decision-making processes.

Governance is one of the first aspects where the investor acts for a greater formalization of processes. This activity is aimed at protecting its position, but also that of minority shareholders. A well-structured corporate governance, in its strategic-organizational meaning, is an important source of corporate value creation, which helps to strengthen transparency and the exercise of shareholders' rights.

It is also possible to affirm that a greater investor activism often involves a more efficient use of corporate assets, with a general mitigation effect of corporate risk.

Investor intervention usually stimulates the adoption of more transparent and structured management practices. From a survey conducted on a sample of 15.000 companies throughout the world through the analysis of 18 selected management performance indicators, it emerges that companies owned by a private equity investor have a better management quality than other types of properties present in the market.[51]

The improvement of management practices can be particularly influenced by the activation of numerous measurement and control activities of company management which are carried out, first of all, with an intensification of the corporate reform. Moreover, very often the intervention of the operator contributes to the creation of a well-defined and structured hierarchical organization, with a greater possibility and capacity of the middle management to autonomously make decisions relating to their specific area of expertise.

An organization of this type is normally preparatory to the dimensional growth of the company and is particularly useful in avoiding that the know-how and decision-making junctions are centralized in one or a small number of individuals. In fact, a situation of this type, in addition to being particularly risky, can represent a major bottleneck for growth.

[51] N. Bloom, J. Van Reenen, R. Sadun, *Do Private Equity Owned Firms Have Better Management Practices?*, American Economic Review, May 2015.

It should be remembered that more complex organizational structures cannot ignore well-defined and aligned schemes of objectives and incentives, which "retain" the management's loyalty to the corporate strategy. Reference is made here to the incentive mechanisms described in the previous chapters, as well as to their structuring on the basis of a long-term time horizon. The aim is to promote as much as possible a great deal of transparency and alignment regarding the objectives and corporate interests, a fundamental element for the proper functioning of all processes.

Secondly, several studies have shown that in companies where there is no active investor, management salary levels often do not reflect the actual contribution of the team to the creation of corporate value. From this point of view, the presence of the investor can in some respects be an opportunity to "restore" a correct monitoring of the performance and activities of the management.[52]

Finally, as already discussed in the previous chapter on investments, within the evaluation process the investor also analyzes, according to a management due diligence process, the structure and managerial skills present in the company. The investor's intervention can therefore be functional to attract new qualified personnel, whose entry can be facilitated and promoted by the investor's activity. According to some research conducted by McKinsey, based on the observation of the transactions carried out by eleven private equity companies with a track record substantially higher than the market average, in 83% of successful investment cases the operator provides for the contribution of external expertise, through the strengthening of management, even before the closing of the deal.[53]

Another very important activity for which private equity operators often intervene to support the entrepreneur or the management team is the drafting of a well-framed and shared development plan (business plan). In parallel with financial projections and estimates, it is essential that a company periodically rethink its positioning and growth strategy within the reference market.

In this regard, the investor's contribution can be multiple. First of all, the preparation of an industrial plan must start from an activity of framing the company reality, its organization and the strengths and weaknesses of the structure and business model. These considerations are very often not dealt with in a structured way, due to the effect or absorption of the managers in the day-to-day, rather than the lack of a real need to communicate to third parties. We should also consider that this work cannot ignore the analysis of the external reality, that is, the macroeconomic and sectoral framework. The intervention of the private equity operator can therefore prove to be an opportunity for the company to stop and think about market changes and their implications in the various aspects of its operations.

[52] S. Noess-Schmidt, *Active ownership: a crucial role for institutional investors*, Copenhagen Economics, 2017.
[53] C. Kehoe, J. Heel, *Why some private equity firms do better than others*, The McKinsey Quarterly, 2005.

It should be considered that in many cases this activity is something completely new for a company, in particular for entrepreneurial realities or family businesses that have always been private. For this reason, the drafting of the company business plan takes on the role of an extraordinary process, which must be properly planned and conducted. The main objective is, therefore, to create greater alignment and a greater sense of belonging for the main figures responsible for primary decision-making processes. This element, which is difficult to neglect, is at the basis of the overall improvement in company management performance.

Parallel to the business planning activity, thanks to the collaboration of the investor, there is normally the launch of a series of extraordinary nature projects, linked to the achievement of specific strategic objectives that go beyond ordinary company operations. It should be remembered that often, as in the case of pre-IPO financing investments, projects of this type are at the very basis of the nature of the operator's intervention.

In this regard, the experience of the investor shareholder can be very useful both for the completion of the projects themselves and for their management and monitoring. For this reason, it is first and foremost essential to identify and equip the company with a corporate development team which structurally operates in support of company management as an interface for the investor. The primary object of the function's activity is precisely the management of the extraordinary, or the coordination of projects of a strategic nature. On a practical level, this consists primarily in the definition of times, responsibilities, and methods, but also in a continuous promotion, through the structure and management, of focusing and organizing for the development and success of the projects themselves.

The presence in the company of a function of this type is of paramount importance for a company whose priority is external growth or internationalization, where the corporate development team is personally involved in the scouting of new acquisition opportunities, collaboration or other. Its contribution can range up to the management of a corporate reorganization process or redefinition of the business model or, as mentioned, to all activities that are not core of ordinary business management.

On the basis of practical experience in literature, it is possible to highlight how in support of this activity it is essential to provide some tools and occasions that make it easy to align all the parties involved and help keep track of the progress of projects, reporting any points of attention. In this regard, one of the tools that should be provided is a "*cockpit*", that is a document that summarizes the objectives, times, and methods of implementation of the main active projects. Periodically updated, a tool of this type is very useful as a basis for discussion and updating for alignment meetings, as well as to highlight any decisions to be made and accumulated delays.

The *cockpit* is an extremely operational tool, considered beneficial for the series of positive effects that its use can entail. First of all, its adoption, thanks to the clarity necessary in defining coordinators and work teams for each site, has an effect of making the resources involved responsible. Secondly, the compilation of the *cockpit* requires the work team to organize a temporal development of the projects, setting intermediate terms and objectives. The use of this type of tools also allows the investor to stay up to date and informed about the progress of the projects, in order to participate with impressions and comments in the development of the projects in which he is most actively involved.

Basically, what is really essential, both for the strategic advancement of the company and for the maintenance of the relationship with the investor shareholder, is to provide for the structuring of processes and functions, with related work tools and roles, which are dedicated to the management and the monitoring of projects of an extraordinary nature.

With reference to support for internationalization, as a fundamental contribution to the growth of target companies, numerous studies and empirical cases testify how, in many cases, many companies have to face various problems in the attempt to internationalize and fail to effectively carry out their internationalization strategies due to a lack of funds and human capital. In fact, it is estimated that 35% of European companies that do not invest in foreign markets are in this situation due to the lack of knowledge of the markets and experience in internationalization practices.[54]

Given the increasing importance of being able to expand in such a globalized market, a problem of this type can really prove to be an obstacle to the survival and growth of the company. In this context, the operator can be decisive in terms of greater availability of funds, thanks to the possibility of providing new capital to support the initiatives considered, human capital and strategic guidance to support the definition of the strategy to be implemented.

According to a study conducted on a sample of 340 European companies, the main efforts for the creation of added value by the investor in operations in later stage ventures, i.e., in already consolidated companies, they are specifically aimed at implementing successful internationalization processes.[55] In fact, numerous studies show that companies owned by private equity operators are more easily involved in cross-border acquisitions, both as buyers and as potential targets.[56]

[54] P. Westhead, M. Wright, D. Ucbasaran, *The Internationalization of new and small firms: a resource-based view*, Journal of Business Venturing 16, 333-358, 2001.

[55] Frontier Economics, *Exploring the Impact of Private Equity on Economic Growth in Europe*, EVCA, 2013.

[56] Z. Sautner, J. Suchard, M. Haumphery-Jenner, *Cross-border Mergers and Acquisitions: the role of private equity firms*, 2012.

According to some research conducted in Italy on a sample of 154 transactions, in 82% of cases the intervention of a private equity operator contributed to improving the internationalization processes. As can be seen from chart 16, which incorporates the results of the aforementioned study, with a view to growth and expansion of the company's business, both geographically and in terms of business areas, acting organically, through so-called "greenfield investments", is not necessarily the only alternative. An equally valid option is to proceed by external lines, or through acquisitions and mergers to consolidate the presence in a geographic area of interest.

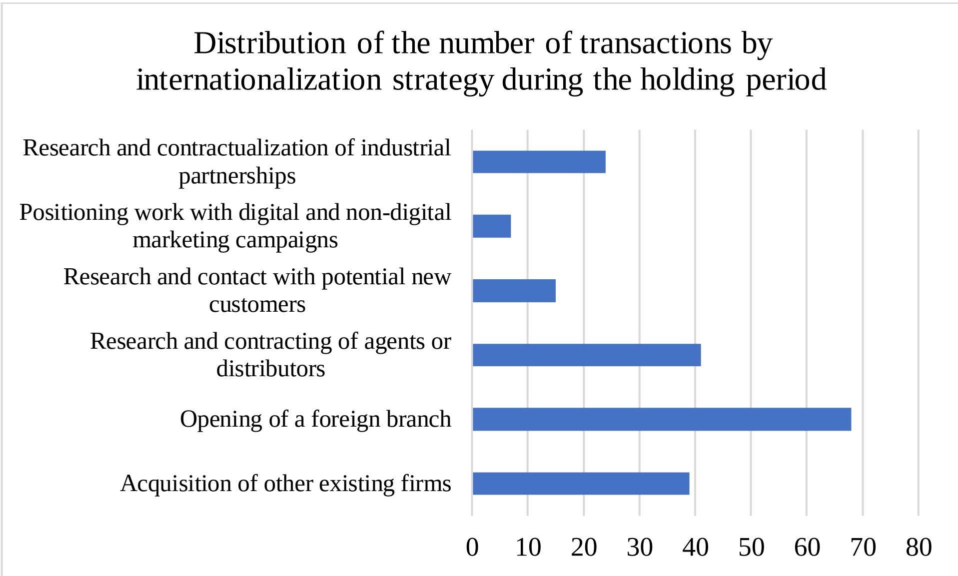

Chart 16. Source: AIFI and LIUC, Internazionalizzarsi per crescere: il ruolo del private equity a supporto delle imprese italiane, october 2019.

In fact, growth through mergers and acquisitions can often be extremely advantageous to the extent that it constitutes a timely alternative to enter a new market by acquiring a good share of it right away. Alternatively, there are several tools for creating strategic alliances with local partners, such as trade agreements or joint venture agreements.

It is precisely in this aspect that the contribution of the institutional investor can be particularly significant. The private equity company has in-depth experience in the field of mergers and acquisitions: the investor has all the skills necessary to build and manage an operation of this type, from corporate valuation to structuring and conducting the deal. Skills that, certainly complex and of a specialized nature, are essential in order to be able to consider and implement a growth strategy based on external lines.

Growth by external lines is certainly an option in internationalization processes, but also in the creation and access to new business areas, as well as in the acquisition of new technologies to support the expansion and improvement of the range of products and services. One of the main factors affecting company competitiveness is size, i.e., the ability to have the critical mass necessary to benefit from economies of scale and the strength and solidity to compete in the market.

In this regard, the specific competence of the investing partner can be decisive in wanting to continue a growth path based on an add-on strategy, i.e., a plan focused on the acquisition by the company (platform) of one or more companies operating in complementary sectors or in new business segments that you want to integrate.

It is also possible that the company wishes to internally set up a corporate venture capital division, that is a function whose activity is entirely dedicated to the scouting of innovative start-ups and owners of technologies that can help the company in facing the competition of its sector. This can allow the company to build a greater competitive advantage over its competitors, being able to count on the possibility of internalizing in advance the skills that are critical for growth within the reference market, thereby “cannibalizing” possible emerging competitors. See for example the case of the American multinational Facebook Inc., which has long started a recurring activity aimed at acquiring from time to time, companies that stand out for the level of innovation and competitiveness within their sector, such as the popular Instagram and WhatsApp services.

In all these cases the investor’s contribution, as active owner, is therefore particularly critical both for his knowledge and experience in extraordinary transactions of this type, and for the possibility of being a capital provider, supporting any banking institutions or other alternative sources of financing. Once again, however, a distinction must be made between the presence of the operator through minority or majority participation. It is clear that, in the event that the institutional investor holds a minority shareholding (as very often happens in growth capital operations), his role can be limited to a consultancy, influence and advice contribution towards the majority shareholders. In the implementation of operations of this type. On the other hand, if the investor holds a majority stake, it can directly influence the strategic choices and promote growth by external lines as the main way to enhance the investment.

The entry of the investor, in general, implies an improvement of the corporate image towards the market and the financial community, acting as a guarantee for the soundness and validity of the business idea. Especially in a context such as the European one, historically more focused on access to the banking system as a primary source of financing, the reputational element is even more important, as it provides the company with a tool to be used in negotiating with the credit institution for the access to more efficient financial instruments and more competitive economic conditions. In other words, it can be affirmed that thanks to the intervention of the operator, the company can see an improvement in the contractual capacity towards the banking system. With particular reference to turnaround investments, i.e., involving companies in bankruptcy or in any case in strong financial tension, the intervention of an institutional investor, especially if of a banking nature, has proved in many cases decisive for pool of banks or new financing plans for the revitalization of the company.

This series of benefits is then expressed in the possibility of reasoning and redefining, with the support and supervision of the investor, a more efficient corporate financial structure, seeking the right balance between debt capital and equity. In practical terms, it is normally a study for the redefinition of the presence, type, and duration of the sources of financing, with the possibility of exploiting the contribution and income of the operator, and therefore in some cases also the occurrence of the so-called change of control, to redefine terms and conditions with banking institutions.

Substantial changes to the financial structure of the company occur, for example, whenever the type of investment is that of the buy-out, where the very nature of the leveraged operation impacts its composition in order to make the most of the company's debt capacity. On the other hand, in the case of venture capital transactions, where the investment is normally structured without the use of financial leverage and through a capital increase, the investment intervention involves an improvement in the capitalization of the company, effectively placing itself as an alternative to traditional sources of credit. Another fundamental of corporate financial coordination concerns liquidity management. Indeed, efficient liquidity management not only guarantees the solvency of the company, but also contributes to its enhancement. The operator therefore tends to be very focused on monitoring the aspects that have an impact on the level of liquidity, such as the trend in working capital and the level of corporate investments.

In general, it can be highlighted how investor intervention can be beneficial for greater focus and more effective management of the corporate treasury. Everything always to be structured taking into consideration the nature of the company's business and its specific needs. The very presence of the institutional investor will also improve the management of relations with other lenders, who will most likely benefit in turn from greater transparency and will trust and feel protected by his support.

Another great contribution of the institutional investor is the financial experience necessary when, among the future steps of the company, there is a further opening towards the capital market, that is the competence and support in extraordinary finance processes. Reference is made here, for example, to the structuring of various types of instruments, mainly relating to the world of private debt, such as bonds, convertible bonds, minibonds and much more. As already mentioned in the course of the paper, private equity, and private debt, in fact, although sometimes investing in companies that are not too dissimilar, are not competitors, but can in some cases even be complementary. The presence of an investor such as the private equity operator can in fact facilitate the collection of risk capital by the company, thanks to the experience already lived and gained with the investor and to the greater level of attractiveness of the company determined by the presence of an institutional participation. The use of this kind of tools can be very useful for the implementation of internal or external growth programs, or for the implementation of investments to support internationalization or entry into new business areas.

With reference to investor support for innovation, numerous studies have shown that the intervention by private capital operators is able to accelerate the business innovation, with consequent effects on the productivity of performance[57]. A possible objection could derive from the fact that this evidence is the result of a cherry-picking effect[58], i.e., from the fact that operators invest mainly in companies more likely to generate innovation. In this regard, further research has shown that the intervention of venture capital operators, regardless of the previous characteristics of the company, leads to a significant reduction in the time-to-market of new products.[59]

Results of this type derive primarily from a greater availability of funds for research and development but are also largely the result of more or less concrete support for a greater focus on market needs and sector trends, derived in part from the previous experience gained by the operator and any resources employed in the company. In addition, supporting the planning and review of corporate management, management and control activities generally helps to create a more positive and efficient business environment in the use of corporate resources.

Wanting to go into more detail, the intervention of the operator in the field of business innovation can refer to one or more of the following fields:

- Assistance and incentive for the review and solution of problems related to the application of existing products and services, quality improvement through the development of new and optimized production processes, and / or more effective technologies.
- Assistance to the company in the experimental development phase of new products or services, as well as in the resolution of any complexities and problems deriving from the early stages of industrialization and structuring of processes.

[57] Frontier Economics, *Exploring the impact of private equity on economic growth in Europe*, *EVCA*, May 2013.

[58] Also known as the fallancyof incomplete evidence, is the act of pointing to individual cases or data that seem to confirm a particular position while ignoring a significant portion of related and similar cases that may contradict that position.

[59] J. Lerner, M. Sorensen, and P. Stromberg, *Private Equity and Long-Run Investment: The case of Innovation*, The Journal of Finance, Vol. LXVI, No. 2, April 2011.

- Protection of the results achieved through support for the application of patents, definition of contracts and management of intellectual property, as well as the search for partners for the exploitation of patents.
- Facilitation and support in finding and training qualified personnel to be assigned to corporate functions for which technical-scientific skills are success factors.

All these areas of activity are very critical success factors for the creation of corporate value, especially in sectors where competition is mainly based on the ability to innovate. Greater attention to these issues, promoted by collaboration with the institutional investor, can result not only in greater company activity linked to innovation, but also in greater economic relevance of the innovation generated.

Faster development of new products and an increased level of innovation also contribute to increase the company's responsiveness to the changing needs of consumers. With this in mind, many operators today emphasize the centrality of the issue of digital transformation, that is, the use of a combination of technologies and methodologies aimed at making business processes more efficient. It is therefore important to invest time and energy in the training of all resources, entrusting the coordination of the project to a dedicated managerial figure with the sensitivity to manage a change in the company's balance.

As already mentioned in the course of the text, a major issue that has become increasingly relevant in recent years concerns the adoption by companies of ESG policies, i.e., practices that take into account environmental, social, and good governance factors that are beneficial for the company and for the community in which it operates. This vision, increasingly focused on the creation of value by the company stakeholders, rather than just for the shareholders, is today at the center of the debate of the industrial and financial community, with the aim of encouraging companies to adopt virtuous behaviors that generate an impact in respect of the environment, of workers, and of society in its complexity.

Following this important signal, in recent years various ESG scores have spread on the market, i.e., rating systems which, similarly to traditional systems focused on corporate solidity, assign the company a score on the basis of which the main institutional investors have started basing their own investment decisions. In fact, we can recall several striking cases of large investors who have decided to take very radical positions with respect to issues of this type, undertaking to divest many of their shareholdings in companies operating with business models and in sectors that are not very sensitive to ESG principles. initiating very strict selection processes for new investments. This is therefore an extremely relevant issue, and above all linked to an extraordinary focus on the part of the company that the operator of private capital, in his fiduciary capacity to support the creation of value, cannot overlook. In this regard, there are essentially two aspects to take into consideration: a formal issue, linked to the need for the company to be competitive and obtain ESG credibility with the financial community, and a substantial issue, linked to the effective implementation of measures. for the preservation of the environment, respect for human rights and good governance rules for the creation of value.

At the end of the paragraph, for its original perspective, the opinion of Micheal Jensen, founder of the Managerial Economics Research Center and of the Journal of Financial Economics, deserves to be cited, who tries to give an answer to what ultimately is the main question. Why is it that private equity investors, normally without specific industrial synergies, are able to make returns on their investments that are often significantly higher than those made by so-called industrial investors? And why such returns do not derive, as some sometimes claim, solely from price arbitrage or the mere use of financial leverage, but are largely linked to the actual and substantial increase in value of the companies in which they have invested, which do they develop at widely higher rates and have levels of efficiency and margins often better than their direct competitors?

Jensen argues that the ability of private equity operators to develop and enhance companies in the best possible way is mainly connected to their aptitude to act as active investors in the acquired shareholdings. These operators, through their deep and active involvement in the strategic activity of the investee companies, allow what he calls "the reemergence of institutional monitoring of management".[60]

In a context where widespread ownership and increasingly stringent rules on the use of confidential information have left management with an almost total, uncontrolled and uncontrollable power, like the US one experienced by Jensen, the presence of investors who return heavily and incisively to carry out a function of control and close monitoring of management, to the point of determining its replacement if deemed inefficient, would seem to be an effective and efficient response to the numerous problems created by what some define as the "excessive power" of management and / or the CEO. The tendency to leave management less and less monitored has in fact allowed, in some cases, a bad management of corporate resources, managing to destroy more than 50% of company value before incurring some kind of reaction from shareholders, often represented by a multitude of

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[60] M. Jensen, *LBOs, and the reemergence of institutional monitoring of managers*, Harvard Business School, 1989.

passive institutional financial subjects, frequently frightened of being too involved in corporate decisions.[61]

In Italy, apart from public companies or some large industrial groups, where such problems could be present, we are probably far from a context such as the represented one. Perhaps we are witnessing a contrary problem: that of the excessive concentration of ownership in the family. But on closer inspection, even family-owned companies could be subject, for other reasons and in different ways, to problems similar to those mentioned by Jensen. Problems due to what we could define as a phase of "immobility" of the property, as well as from an irrational and unreasonable use of company resources, in the continuation of an interest purely focused on ownership and not on the environment that surrounds the company. Hence, in these cases, the logic set out by Jensen, although developed overseas and in an economic context very different from the European and Italian one, appears less distant and it could be that private equity operators, as long as they are professional and competent, acting with an active ownership approach, may represent a possible and, perhaps in many cases, desirable solution.

ii. Main results from previous international research

Over the last few years, numerous research have been carried out having as objective the analysis of the contribution of private equity and venture capital operations to economic growth. Most of these studies are summarized in a document produced in 2013 by Frontier Economics for EVCA (European Venture Capital Association), which focuses on the impact of operations in terms of innovation, productivity, and internationalization.

First of all, private equity is able to increase innovation, not just by providing capital for research and development, but also, for example, helping the company to focus on its own strengths. Typically, this impact is measured by the number of patents. The relationship between patents and economic growth is not clear cut, and patent regimes are not a primary determinant of growth. However, the vast majority of new product innovation gets patented, making patents an effective proxy of innovation activity.

Popov and Rosenboom, for example, use data on 21 European countries in the period 1991-2004 and show how 12% of private industrial innovation derives from private activity equity, while private equity investment accounts for 8% of aggregate (private equity plus R&D) industrial spending[62]. This

[61] A. Gervasoni, F. Sattin, *Private Equity e Venture Capital: manuale d'investimento nel capitale di rischio*, Guerini Next, 2020.

[62] A. Popov, P. Rosenboom, *Does Private Equity spur innovation? Evidence from Europe*, European Central Bank, June 2009.

is explained by Popov and Roosenboom's finding that R&D investment by private equity-backed firms is more effective than R&D investment by non-private equity-backed firms. Their estimates show that €1 of private equity finance can be up to nine times more effective than €1 of non-private equity finance in delivering innovations as measured by patents granted. The magnitude of this impact varies by sector, with biotechnology showing the strongest impact. The key conclusion of this study is then supported by Mollica and Zingales (2007). They explore the direction of causality using data from 23.565 private equity-backed companies in the US. Their findings confirm that private equity investment (in particular venture capital) results in increased innovation, rather than the other way round (namely the argument that private equity selects more innovative firms). Furthermore, when companies are facing difficulties accessing finance, even if private equity funds select only the most innovative companies, the provision of funds to support this type of investment is still a valid contribution to innovation[63]. Also, according to a study realized by Gambardella et al. (2008), 116.000 patents are attributable to private equity-backed companies, for a corresponding value of 350 billion euros in the previous 5 years.[64]

Other research indicates that innovations delivered by private equity-backed firms are economically more significant. A 2011 analysis provided by Lerner, Sørensen and Strömberg on 495 leveraged buy-outs made on an international level between 1980 and 2005, highlights how operators help companies to focus on the areas that allow them to produce more innovation. They find that on average, the citations for patents increase from an average of 1,99 times before private equity participation to 2,49 after private equity investment[65]. This is crucial because it means that the initial investment in R&D and innovation by private equity funds is more likely to yield positive outcomes, generate a return and economic value. Therefore, private equity appears to be associated with a beneficial refocusing of firms' efforts to deliver increased innovation. Private equity firms also provide corporate governance support and business expertise to improve firms' innovation efforts, as pointed out by Bloom et al. (2009).[66]

In addition to support for innovation, further research show how private equity contributes to making portfolio companies more productive, supporting aggregate economic growth. Productivity is meant as the efficiency with which inputs, such as capital, labor, land, and materials are turned into outputs. Increased productivity helps the target companies to deliver more goods from the same level of inputs.

[63] M. Mollica, L. Zingales, *The Impact of Venture Capital on Innovation and the Creation of New Businesses*, University of Chicago, 2007.

[64] A. Gambardella, D. Harhof, B. Verspagen, *The value of European patents,* European Management Review, 5(2), pp. 69-84, 2008.

[65] J. Lerner, M. Sorensen, P. Stromberg, *Private Equity and Long-Run Investment: The case of Innovation,* The Journal of Finance, Vol. LXVI, No. 2, April 2011.

[66] Frontier Economics, *Exploring the Impact of Private Equity on Economic Growth in Europe*, EVCA, 2013.

For example, a better practice for realizing a procedure may mean that is performed in a reduced time frame. Among the interventions that can be implemented by private equity investors we find, for example, strategic and managerial improvements, economies of scale, employee incentives, which lead to time saving and to a greater ability to exploit business opportunities.

There are several ways to measure company performance. For the purposes of gauging the relationship between company performance and productivity, the most relevant measures relate to the company's operational performance. As such, the typical measure used in research is the company's operating profit per employee. The performance of private equity-backed firms has been researched widely. The majority of the research finds a positive relationship between private equity participation and company performance, showing a clear relationship between private equity involvement and company profits, growth, and survival.

A study provided by Ernst & Young in 2012, analyzes 473 investments made in Europe in the period 2005-2011 and demonstrates how the target companies are characterized by an average growth in EBITDA per employee of 6,9%[67]. Similar results emerge from a study by Davis et al. (2009) which, using a sample of US companies subject to private equity investment, highlights a differential in terms of productivity increase compared to comparable companies by 5,2%[68]. Furthermore, according to the research, target firms experience an intensification of job creation and job destruction activity, establishment entry and exit, and establishment acquisition and divesture (all relative to controls) in the wake of private equity transactions. Moreover, a paper realized by Croce and Martì (2014), studying the reluctance of family firms to accept private equity investors and the impact of private equity on firm's performance, highlighted how family firms that access private equity investors are mostly growing family firms, where funding and added value provided by the investor lead to a significant improvement in productivity growth.[69]

According to Kaserer (2011), about two thirds of the overall performance is attributable to strategic and operational activities, while the use of financial leverage affects only one third of returns. However, the study did not find robust evidence that investment returns are effectively increased by the leverage[70].

[67] Ernst & Young, *Branching out: How do private equity investors create value? A study of European exits*, 2012.

[68] J. Davis et al, *Private Equity, Jobs and Productivity*, American Economic Review, 2009.

[69] A. Croce, J, Martì, *Productivity growth in private-equity-backed family firms*, Entrepreneurship Theory and Practice, 2014.

[70] C. Kaserer, *Return Attribution in Mid-Market Buy-Out Transactions – New Evidence from Europe*, 2011.

Cressy et al. (2007) examine 122 leveraged buy-outs in the UK market between 1995 and 2000, highlighting that the operating profitability of the target companies of the private equity is, in the first three years after the investment, 4,5% higher than non-participated companies[71]. Another productivity indicator, used in many analyzes, is related to the degree of bankruptcy: some recent academic studies, including that of Tykvovà and Mariela of 2012, state that operator intervention does not increase the chances of default. As evidence of this, Thomas (2010) shows that the failure rate of private equity-backed companies' is up to 50% lower than a sample of comparable companies. Another topic of great interest is undoubtedly the impact of private equity and venture capital on employment level: the above-mentioned EY study shows an annual growth in the number of employees in the target companies of 2,2%, against a European value that fluctuated during the period 2007-2011 between -1,8% and + 1,8%. Beyond the increase in the level of employment, employees of investee companies are also more satisfied, as stated in a study of Gospel of 2010.[72]

	BIS (2008)	Kaplan and Stromberg (2009)	Thomas (2010)
Number of private equity portfolio companies	21,000	21,000	7000
Average company failure rate	7.5% (1,575 companies)	7.5% (1,575 companies)	7.5% (525 companies)
Private equity impact on company failure	5% lower	25% lower	50% lower
Estimated number of annual company failures avoided due to private equity participation	80	400	260

Table 6. Source: Portfolio company data from EVCA, company failure rate data from Eurostat, impacts from BIS (2008), Kaplan and Stromberg (2009), Thomas (2010). Note that estimates by Thomas apply to buy-out investments only.

A research provided by Scellato and Ughetto (2013), investigates the effects of buy-out deals on the ex-post performance of target companies. The analysis is based on a sample of 241 private-to-private buy-outs involving European firms between 1997 and 2004 and a control sample of non-buy-outs. The study explores three different dimensions of the firm performance: size, profitability, and productivity. The results indicate a positive impact of buy-outs on the growth of total assets and of employment in target firms in the short- and mid-term. However, an equivalent clear pattern could not be identified for productivity, while they estimate a lower operating profitability for buy-out companies with respect to the control group three years a deal is made. Restricting the analysis to a sub-sample of buy-out companies, they found that generalist funds negatively and significantly

[71] R. Cressy, F. Munari, A. Malipiero, *Playing to their strengths? Evidence that specialization in the private equity industry confers competitive advantage*, Journal of Corporate Finance, 13(4), pp. 647-669, 2007.

[72] Frontier Economics, *Exploring the Impact of Private Equity on Economic Growth in Europe*, EVCA, 2013.

impact the average ex-post operating profitability of private equity-backed companies, while turnaround specialists are positively associated with operating profitability. The evidence also highlights that target companies whose lead investor is located in the same country show relatively higher ex-post profitability performance[73].

Regarding the employment contribution enhanced by private equity investments, a 2005 EVCA research paper reveals that private equity and venture capital play a vital role in the conservation and creation of employment at a European level. The larger buy-out-financed companies the majority of jobs, accounting for close to 5 million or 83% of the total number of people employed (at that time) by private equity and venture capital target companies. In addition to its role in employment conservation, the study underlines the private equity role in the creation of new jobs. Between 1997 and 2004, the buyout-financed firms surveyed in this study experienced an average growth rate employment of 2,4% per year following the buy-out transaction. This is nearly four times the annual growth rate of employment in the EU 25 (0,7%) between the years 2000 and 2004.[74]

The third field of analysis on the economic impact of private equity is related to the benefits in terms of competitiveness: in particular, numerous studies demonstrate the contribution to the processes of internationalization, often very difficult for smaller or younger companies. Private equity can play a crucial role in helping investee companies to overcome these hurdles in two key aspects: first of all, there is support in defining the best strategies for entering new markets. In addition, the necessary capital is provided with the aim to implement such internationalization strategies. Based on data from 340 companies, a study by Locket et al., for example, shows that the early-stage companies' support is mostly based on creating a propensity to export, while for companies at a later stage it relies in particular in the monitoring of activities[75]. Finally, from a study by George et al. on Swedish companies (2005), emerges the greater inclination towards internationalization of firms with "external owners", as in the case of private equity.[76]

After combining a review of the studies carried out in recent years at an international level, we can observe that most of them have found a decidedly positive impact of private equity on target companies, supporting them by increasing the level of innovation, productivity, internationalization,

[73] G. Scellato, E. Ughetto, *Real effects of private equity investments: evidence from European buyouts,* Journal of Business Research, 2013.
[74] EVCA Research Paper, *Employment contribution of Private Equity and Venture Capital in Europe,* November 2005.
[75] A. Lockett er al., *The export intensity of venture capital backed companies,* Small Business Economics, June 31(1), pp. 39-58, 2008.
[76] G. George, J. Wiklund, S. Zahra, *Ownership and the Internationalization of Small Firms*, Journal of Management, April 31(2), pp. 210-233, 2005.

and competitiveness. However, in some cases there is also evidence of a non-positive impact on the performance of the companies in the period immediately following the investment.

iii. Specific research about the contribution of Private Equity to Italian SMEs

The Italian market mainly relies on small and medium-sized enterprises (SMEs). To better understand the weight of SMEs within the Italian economic and production framework, it is good to linger on the numbers. Out of 4,4 million active enterprises in Italy, micro-enterprises with fewer than 10 employees are numerically the most important ones, representing 95,05% of the total, against 0,09% of large enterprises. On the other hand, Italian SMEs are about 206 thousand, i.e., the remaining 4,86% of the Italian entrepreneurial market, and are responsible, alone, for 41% of the entire turnover generated in Italy, for 33% of the total number of employees in the private sector and 38% of the country's added value. Looking then at productivity, it emerges that Italian SMEs are doing well: they generate an added value well above the 48 thousand euros per employee of the European average. The same cannot be said for large and micro enterprises, where the Italian scenario is far from the European average values. For all these reasons, therefore, SMEs have all the credentials to be able to give impetus to the Italian economic (and territorial) development, also thanks to the increasing support provided by private equity investors. Making a comparison with the Italian scenario, based on the parameters analyzed in the previous paragraph, we note how the impact of private equity on Italian companies is mostly positive. From a study provided by AIFI in 2020 (involving 127 operations distributed over 125 companies), regarding ESG parameters related to private capital activity in Italy, it emerges that the average annual growth in the number of employees is elevated in buy-out (+111%) and replacement operations (+54%), while it is lower in growth capital operations (+11%) and negative in turnaround interventions (-9%). However, the average number of employees has increased overall by 89%.[77]

Referring, instead, to innovation supported by private equity companies, a study carried out by the LIUC university in collaboration with AIFI, with the aim of analyzing the ability to induce innovation by measuring the filing of new patents and trademarks, shows how the patenting activity of private equity-backed firms, in the sample taken into consideration, is higher than the Italian average (27% against 5% of the reference benchmark). In absolute terms, it is the targets of the buy-out operations that file the most patents. The companies that show a greater propensity for innovation are concentrated in the manufacturing and large-scale distribution sectors. Moreover, according to the study, the majority of companies that file post-investment patents are those that have patented even

[77] AIFI, *Analisi delle risorse umane e delle pratiche ESG nelle target del private capital*, September 2020.

before the investment. In relative terms, growth capital operations are those that file the most patents (24% compared to 18% of buy-out operations).[78]

Finally, to analyze the impact of private equity on the support related to the internationalization of companies, reference is made to a study conducted by the LIUC university, again in collaboration with AIFI, which studies a sample consisting of 833 growth capital and buy-out operations, carried out between 2006 and 2015 in Italian companies. The research states that in 82% of transactions, private equity contributed to improving internationalization processes. Among the companies not yet internationalized, during the holding period 45% of them decided to enter foreign markets. The preferred internationalization strategies are the opening of an office abroad, the search and contracting of agents or distributors and M&A. In 82% of cases, the targets increased the weight of foreign turnover during the holding period, mainly using the opening of an office abroad as a strategy. Instead, the companies that have carried out M&A activities (mainly SMEs operating in the industrial and consumer goods sectors) have carried out on average almost two transactions each, favoring the acquisition of competitors.[79] The benefits brought by the private equity-target operator partnership on the Italian market also clearly emerge from a study conducted by the Bank of Italy and AIFI in 2009, carried out by collecting information relating to 57 transactions. The results indicate that the operators provided support mainly on financial aspects and on the definition of strategies. They also played a "certification" role, facilitating the collection of funds from other lenders and improving relations with banks. On the contrary, the contribution in terms of technical product development, human resource management, marketing policies and improved access to suppliers and distributors is reduced.[80]

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[78] LIUC and AIFI, *Monitor Sviluppo Capitali e Innovazione, Private Capital Conference,* October 2020.
[79] LIUC and AIFI, *Internazionalizzarsi per crescere: il ruolo del private equity a supporto delle imprese italiane,* 2019.
[80] Bankit & AIFI, *Il Private Equity in Italia, Questioni di Economia e Finanza,* 2009.

Type of Involvement	All Firms	Of which: Seed / Start-up	Of which: Expansion
Operations started abroad	67%	63%	80%
Technical-operational advisory	11%	14%	0%
Financial advisory	84%	82%	64%
Definition of strategies	81%	92%	50%
Human resources management	41%	36%	36%
Marketing advisory	26%	30%	10%
Improving access to suppliers / distributors	27%	31%	27%
Improvement financial institutions' relationships	76%	85%	60%
Better access to the stock exchange market	70%	40%	64%

Table 7. Source: Bankit & AIFI, Il Private Equity in Italia, Questioni di Economia e Finanza, 2009.

To further explore the impact that private equity funds have on the performance of target companies, it is necessary to mention some research carried out in the past years. A recent study called "The economic impact of Private Equity and Venture Capital in Italy", carried out by PwC (PricewaterhouseCoopers) in March 2018, shows that companies owned by private equity or venture capital funds have performed better than other Italian companies in terms of revenues from sales and services, EBITDA, and employment.

This research took into account a sample of 499 disinvestments, of which 218 of venture capital (also including growth capital) and 281 of buy-out, carried out in Italy from 2008 to 2018. Within the study, the performances are indicated through the average of the CAGRs (compound annual growth rate) recorded by each company included in the sample and then compared with the reference benchmark. The analysis revealed that the companies owned by private equity and venture capital funds were characterized by an annual growth in revenues of 5,5%, about four times more than the Italian companies taken as benchmarks (1,3%). This growth rate was significantly higher than the growth of the Italian gross domestic product, which stood at around 0,7%. As regards the employment rate, unlike the positive but stationary 0,0% recorded in the reference sample, the companies in which private equity operators have an interest recorded an annual increase of 5,1%.

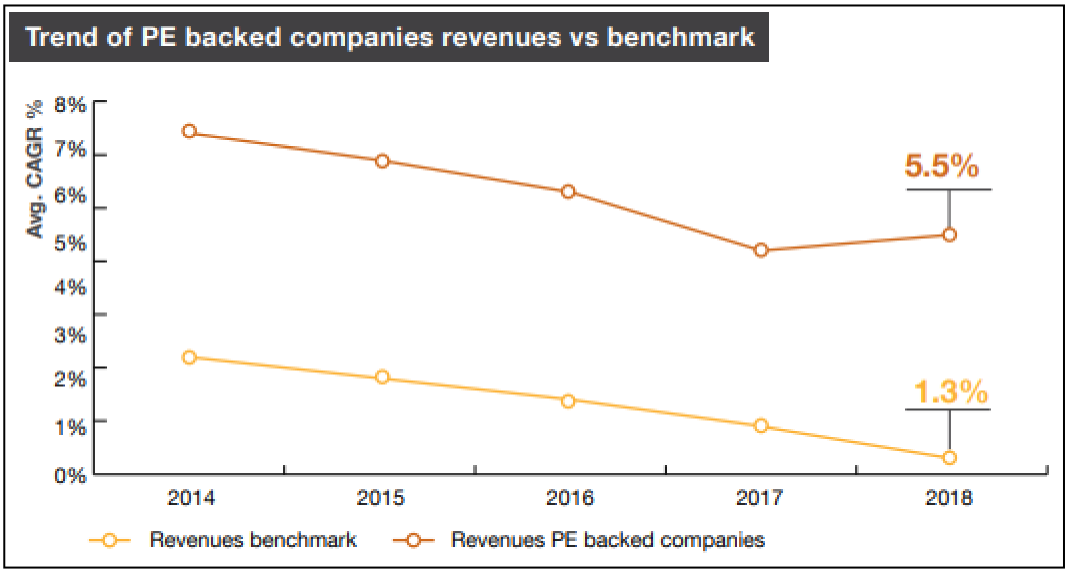

Chart 17. Source: PwC, The economic impact of Private Equity and Venture Capital in Italy, 2018.

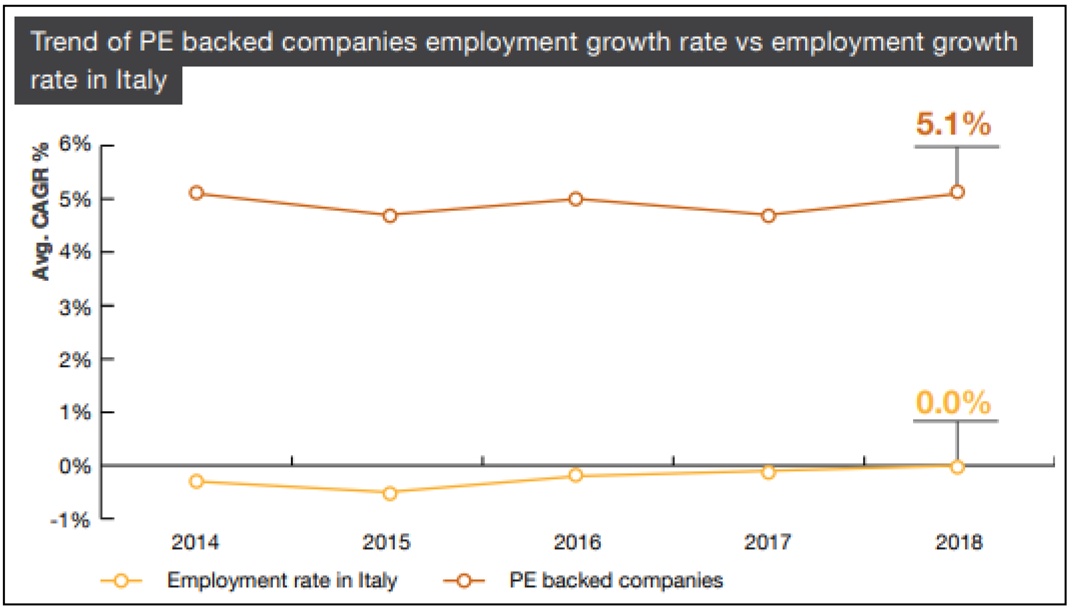

Chart 18. Source: PwC, The economic impact of Private Equity and Venture Capital in Italy, 2018.

In detail, analyzing the venture capital operations, data shows that the companies involved in the investment were characterized by a growth rate of revenues equal to 8,2%, against 1,4% of the reference sample. Similarly, the growth in terms of EBITDA was 14,8%, compared to -0,8% of the benchmark. Even taking into consideration the data of the same study, however, referring only to buy-out operations, the values are positive. In fact, the annual growth in revenues of the companies invested by private equity operators was 3,4%, against 1,3% of the reference benchmark. The most significant data concerns the annual growth of the EBITDA of the companies under study, which stood at 3,4%, compared to -0,7% of the benchmark.

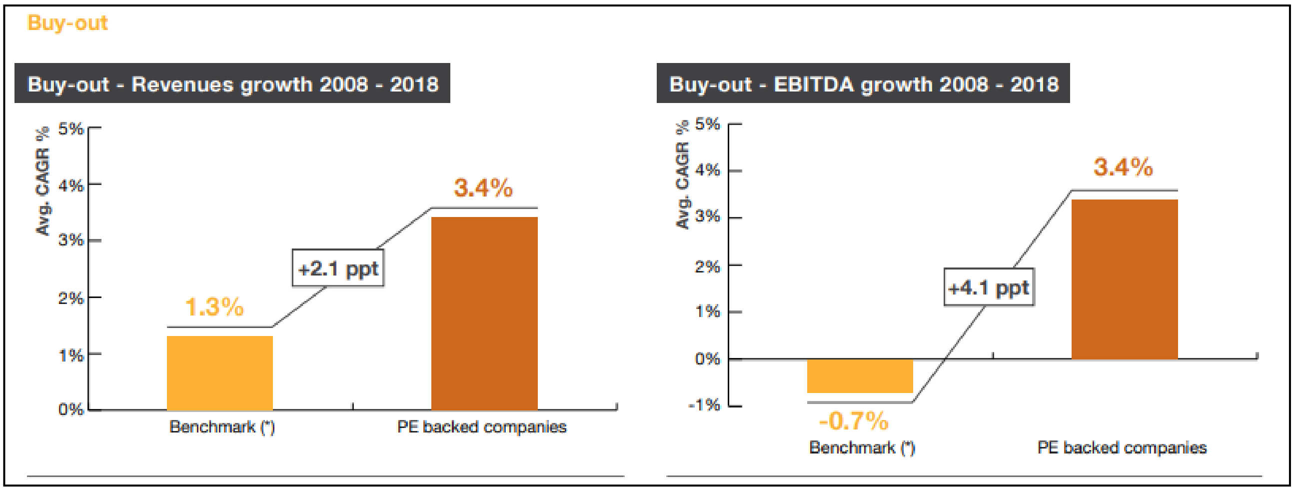

Chart 19. Source: PwC, The economic impact of Private Equity and Venture Capital in Italy, 2018.

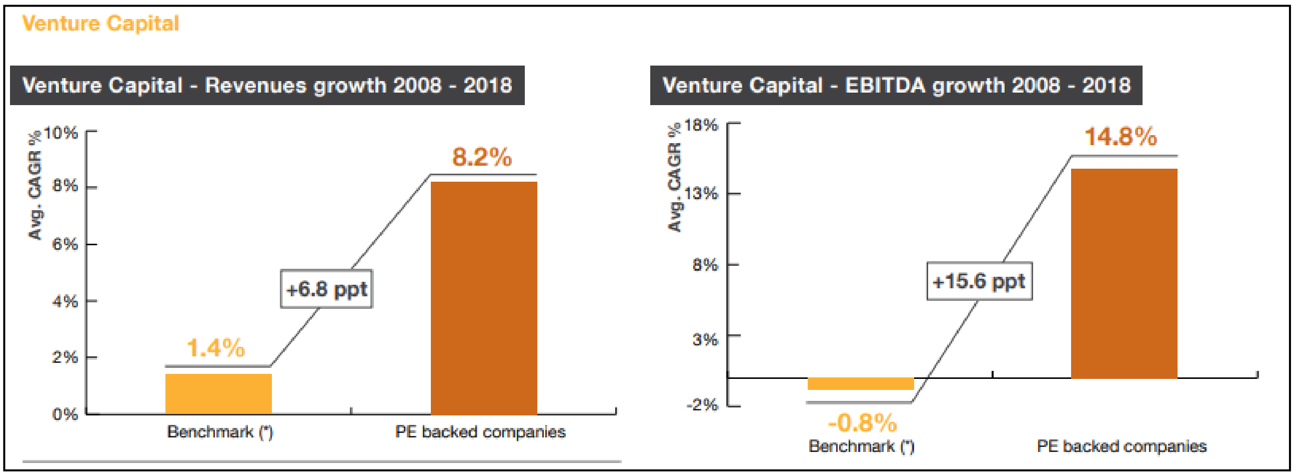

Chart 20. Source: PwC, The economic impact of Private Equity and Venture Capital in Italy, 2018.

A study conducted by the LIUC University in January 2014 called "The economic impact of private equity in made in Italy", examines the private equity transactions carried out in Italy from 2007 to 2012 (excluding investments made by public operators, those addressed to start-ups and secondary buy-outs). As regards the sectoral analyzes, the ISTAT data were analyzed referring only to the product categories that make up the 4 sectors of Made in Italy: food, clothing, mechanical-automation, furniture-design. In order to study the economic impact of private equity on the target companies operating in the Made in Italy, the most general economic parameters were analyzed, but indicative of the management and performance of the companies, i.e., the revenues from sales and services and the employment level of the companies. company, understood as the number of employees per year. The results were compared with those recorded by ISTAT in the same period in the same time period for all Italian companies. Analyzing the data of the companies active in the Made in Italy sectors, from the research it emerged that between 2008 and 2010 the companies in which private equity holdings registered a growth in turnover equal to 4,3%, while the ISTAT data relating to the same period and the same sectors show a decrease of 5,1%. Even compared to GDP, which recorded a decrease of 1,9% between 2008 and 2010, the performance of companies held by private equity funds are certainly very positive. Similar results characterize the level of employment: the study, in fact, shows a positive trend with a CAGR of +4,1% for the companies subject to investment, which exceeded the reference benchmark, characterized by -4,0%.[81]

It is also worth mentioning, although not so recent, a similar investigation conducted in 2008 by Francesco Bollazzi, professor at LIUC University. The study aims to analyze the economic impact generated by institutional venture capital investors in development finance operations (growth capital) targeting a family business, in the interval between the year of entry and the year of exit of the shareholding structure. The database of operations used as a sample (33 operations in total) of the research consists of operations in which the investor's entry year does not exceed 2004. This situation is a direct consequence of the average medium-long time horizon typical of private equity investments. Furthermore, the sample shows that more than 50% of the operations were carried out between 2000 and 2001. In order to fully understand the economic impact attributable to the private equity company, it was decided, as previously specified, to consider only operations whose intervention cycle had ended, that is, which had already been divested. A series of indicators considered significant were then chosen and the changes that occurred during the observation period were assessed. Similar to the research cited above, the parameters chosen to carry out the aforementioned analysis are revenues, EBIT, EBITDA, net profit, and some significant indicators from an equity point of view, such as working capital, net fixed assets, and shareholders' equity. These changes were not determined as mere percentage changes, but in the form of CAGR. With the support of a private equity operator, as far as turnover is concerned, the research shows a significant impact in terms of growth, in fact only 18% of the companies belonging to the sample recorded a negative CAGR during the period of stay of the operator. Most of the company recorded positive performances between 0% and 10%, reaching companies that have achieved growth of over 90% (12% of the sample). A similar study was conducted with reference to EBITDA. According to the study, the presence of negative changes was recorded for 39% of the companies belonging to the sample, while the remaining 61% maintained a positive trend during the investment period. Among others, 18% of the sample shows an average annual growth even higher than 90%. Finally, focusing on net profit, the research shows an average positive change of 14,78%. However, it is noted that 45% of the companies belonging to the sample obtained negative variations with reference to the net result and 24% of the sample recorded absolute negative net results. The conclusions of the research affirm that

[81] A. Muzio, A. Pisano, *L'impatto economico del private equity nel Made in Italy,* LIUC Papers, January 2014.

the collaboration between the private equity investor and the family businesses has clearly had an extremely psychological impact on the growth process of the target companies. This evidence assumes an even more significant value if it is reflected that most of the reference years have certainly not been years of marked economic development, at least in Italy. The empirical analysis of the study, however, allows to highlight very different outcomes associated with the operations. If more than 60% of companies show undoubtedly successful performances, there is, at the same time, the presence of a group of companies with reference to which there are no positive results in terms of development. This figure, identifiable with 39% of companies that contract their EBITDA, while presenting positive CAGRs relating to certain indicators, clearly shows some critical issues, precisely in the face of a decline in EBITDA, a key parameter for identifying value creation. It is therefore important to underline how criticalities may also exist within the relationship between private equity and family businesses, without forgetting the positive evidence.[82]

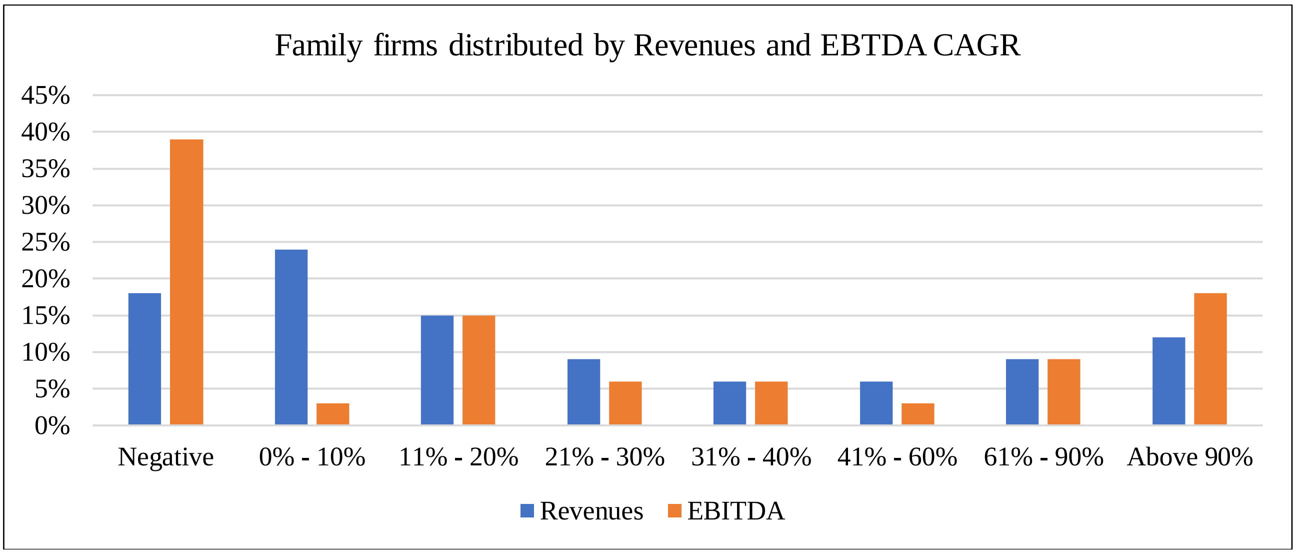

Chart 21. Source: F. Bollazzi, Il processo di sviluppo delle aziende familiari: il contributo del private equity, Amministrazione & Finanza 6, 2008.

To conclude the chapter, we noted how, both international research and those concerning Italian target firms, in different periods, have shown that private equity investment has a mostly positive impact in qualitative and quantitative terms on the performance of target companies. However, in some cases we have seen scenarios in which the changes in the operational indicators of the target companies were definitely negative ones.

[82] F. Bollazzi, *Il processo di sviluppo delle aziende familiari: il contributo del private equity,* Amministrazione & Finanza 6, 2008.

IV. Chapter Four: Empirical Analysis - the impact of Private Equity on the performance of target SMEs

As we have seen in the previous chapters, among the many characteristics that represent Italy, certainly one of the most significant is the massive presence of small and medium-sized enterprises (SMEs), whose contribution does not extend only to the economic aspect, but also occupies an important place in the Italian cultural and social life.

The objective of this chapter is to understand the impact of private equity investments on the main economic-financial indicators of the companies subject to investment, in order to understand if the benefits that the literature highlights are also attributable to the sphere of Italian small and medium-sized enterprises.

After a methodological introduction, which describes the method of analysis and the adopted sources, the main characteristics of the sample under examination will be presented, after which the results of the research conducted will be explained. Finally, after comparing these results with the relative benchmarks, a similar analysis will be conducted on the companies' performance itself, before and after the investment year.

i. Methodology

The empirical analysis aims at understanding if and how the institutional investor has generated value and identify its real contribution to the development path of the investee company. It is conducted on private equity transactions carried out in Italy from 2013 to 2016. The transactions are identified in the annual reports published by the Private Equity Monitor (PEM), which takes into consideration only "the new investments made by institutional investors in private capital risk, in all phases subsequent to those of business start-up, thus excluding investments made by public or para-public operators, venture capital operations and reinvestments in companies owned by the same operator, the so-called follow-on".[83] With reference to each company in the sample, a series of information and indicators were acquired which made it possible to carry out an analysis on two levels: qualitative, framing the phenomenon in question at a temporal, geographical and sectorial level; quantitative, through budget, financial, performance and employment indicators.

More specifically, to study the economic impact of private equity on target SMEs, income indicators (EBITDA and Net Profit) and dimensional indicators (Revenues, Employees and Total Assets) will be examined. The data of the companies were obtained through the AIDA - Bureau Van Dijk

[83] www.privateequitymonitor.it

database, containing the financial statements, personal and product data of all active and bankrupt Italian joint stock companies (excluding Banks, Insurance Companies and Public Entities).

The results of the study will then be expressed in terms of CAGR (Compound Annual Growth Rate), which measures the annual growth of a particular indicator over a specific period of time. In this regard, the three annual financial statements before and after the date of the investment will be taken into consideration. Normally a private equity investment has an average duration of 5/10 years, for this reason it is believed that considering the economic-financial indicators in the three years following the investment is sufficient to understand the impact of the investment itself. The choice of the four years to be analyzed is also guided by the limits of the aforementioned database, which does not allow to access data prior to 2010.

First of all, the analysis will focus on to comparison with several reference benchmarks, to understand if and to what extent the results provided by the sample differ from the results recorded for companies that are not owned by private equity funds. In particular, the benchmarks taken into consideration are three: Macroeconomic indicators (such as national GDP and Employment Rate), Mediobanca-Unioncamere research, which presents the annual results of Italian industrial SMEs between 2008 and 2018, and data provided by ISTAT (National Statistical Institute) which provides the economic annual results of Italian companies.

Subsequently, the data collected will be used to carry out several analyses on the sample, including a comparison of targets' performance in the three years before and after the investment, in order to have a complete picture of the type and extent of the impact provided by private equity operators. In this way it will also be possible to understand if this impact is significant or if similar growth rates were recorded even before the investment, therefore attributing to the operator the ability to select specific companies that record higher returns and growth rates than others, in order not to modify the previous trends of acquired companies and helping to maintain or even accelerate the performance of already growing companies.

ii. Sample Definition

For a better overview of the phenomenon investigated below, a description of the morphology of the sample identified is mandatory. First of all, as already mentioned, it was decided to consider, through the PEM database, all the investments (not necessarily already divested) made between 2013 and 2016, in order to be able to collect all the necessary financial statements available on the AIDA database before and after the investment date.

The former sample is composed by 360 companies (69% buy-out, 25% growth capital, 4% turnaround and 2% replacement). For obvious statistical reasons, the analysis will mainly focus on buy-outs and growth capital transactions, thus not considering the other typologies. Furthermore, for some of the transactions covered by the experiment, it was not possible to retrieve the data on the financial statements from the AIDA database because of their absence or incompleteness. After this first screening, the sample amounts to 152 companies.

Since the objective of the paper is to analyze the performance of small and medium-sized enterprises, the second exclusion to be made is that of large companies. Companies that "employ more than 250 people, have a turnover of more than 50 million euros and have an annual balance sheet total of more than 43 million euros[84]" were therefore excluded. In addition to this, it was also considered appropriate to exclude transactions characterized by a secondary buy-out deal, referring to "transactions involving the sale of a portfolio company by one financial sponsor or private equity firm to another[85]". The main reason is that, since the control of the company is already in the hand of a private equity or venture capital investor, it is not possible to analyze the impact due to the intervention of an investor who acquires the company, or part of it, from a private owner.

After necessarily excluding these two types of elements, the total number of companies decreased to 107, representing the complete sample that will be analyzed during the chapter. The graph below shows the number of transactions analyzed for each of the years taken into consideration. The number of investments in the sample is fairly homogeneous for each year, and slightly growing, resuming the trend of constant annual growth of total private equity investments at Italian level.

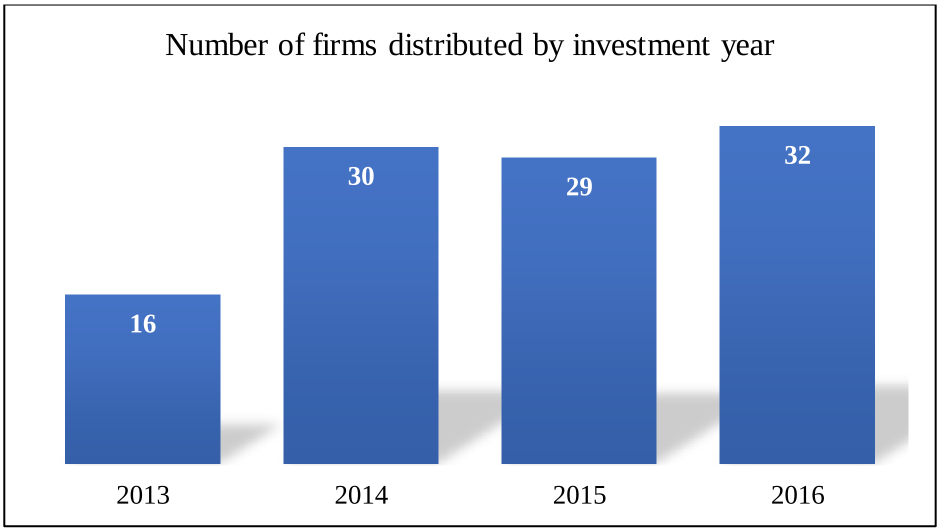

Chart 22. Source: Self-elaboration.

[84] *Definition provided by Italian Ministry of Economic Development.*
[85] *Definition provided by Investopedia.*

Analyzing the sample from a sectorial point of view, in graph 22, it is shown how the investments under analysis are broken down, adopting the Standard Industrial Classification which is the reference sector classification in the international context.

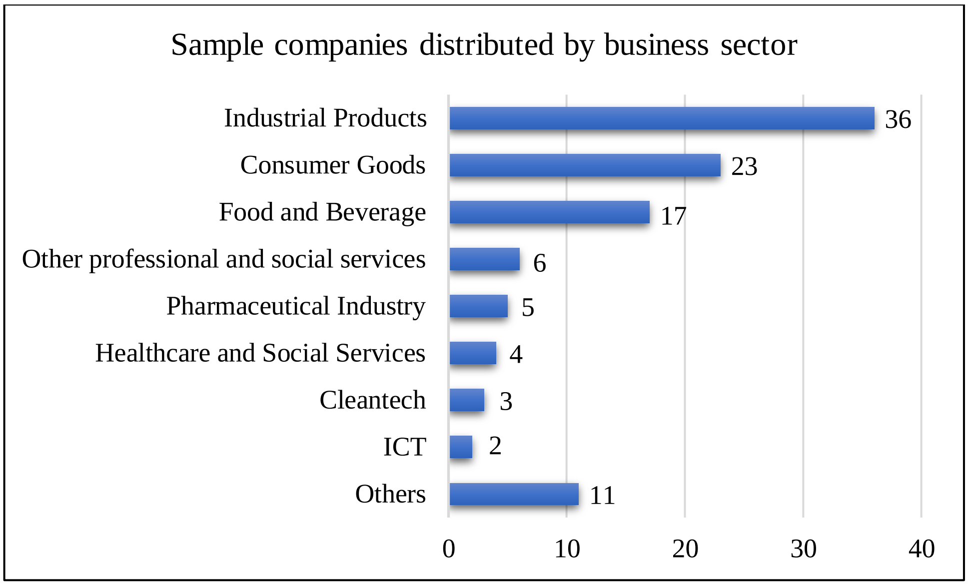

Chart 23. Source: Self-elaboration.

In particular, 33,6% of the small and medium-sized enterprises in the sample operate in the industrial products sector. Following this, with a percentage equal to 21,5% of the total, are the companies belonging to the consumer goods sector, while the third most invested sector is that relating to food and beverage with a percentage of 15,9%.

Another important and deserving aspect of further study is the one relating to the amount of share capital through which the investor enters the shareholding structure of the target company. In graph 24 it is possible to visualize this aspect, specifying that the individual punctual data have been distributed by significant intervals.

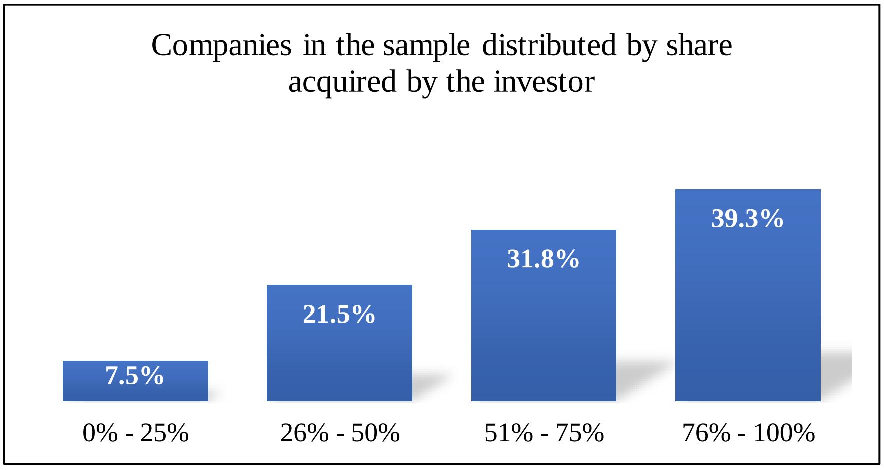

Chart 24. Source: Self-elaboration.

The operations of the sample are increasingly distributed. In particular, 7,5% of the sample acquired shares not exceeding 25%, 21,5% shares between 26% and 50%, 31,8% shares between 51% and 75%, lastly 39,3% shares ranging between 76% and 100%. Consistently with the types of transactions taken into consideration, i.e., buy-outs and growth capital, most operations are characterized by the acquisition of a majority stake by the private equity investor.

The last qualitative feature worth analyzing is the regional distribution of investments within the sample. From graph 25, shown below, we observe how the great majority of the investments taken into consideration were made in targets located mostly in northern Italy, in particular in Lombardia, where the number of companies is also very high compared to other regions.

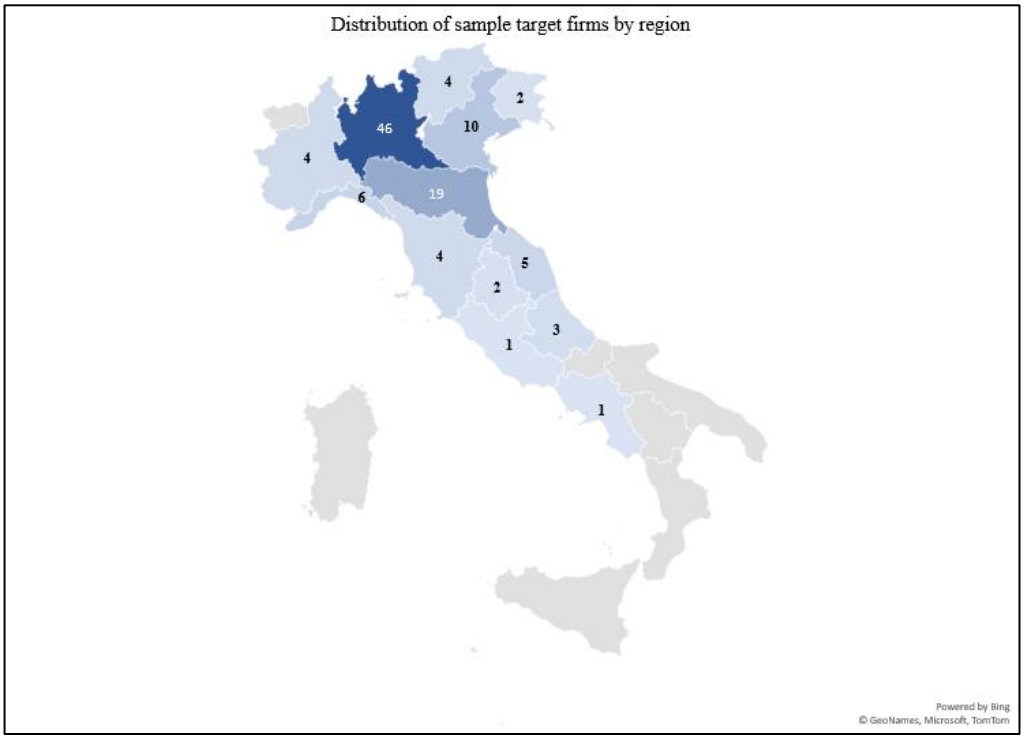

Chart 25. Source: Self-elaboration

In terms of performance, it was deemed appropriate to immediately frame the impact of private equity investments, showing the distribution of the companies contained in the sample by CAGR of the main analyzed indicators. Graph 26 shows the distribution of the companies contained in the sample by dimensional indicators' CAGR, thus involving revenues, total assets, and employment.

Important information regarding the distribution of the sample is obtained from the above-mentioned graph, in fact, as we have already observed in chapter three from a similar study drawn up by Francesco Bollazzi, for all three indicators, a part of the companies within the sample shows negative annual growth in the three years following the investment. The majority, on the other hand, has a growth ranging from 0% to 10%, while the companies that have a growth of more than 60% are less than 4% of the sample.

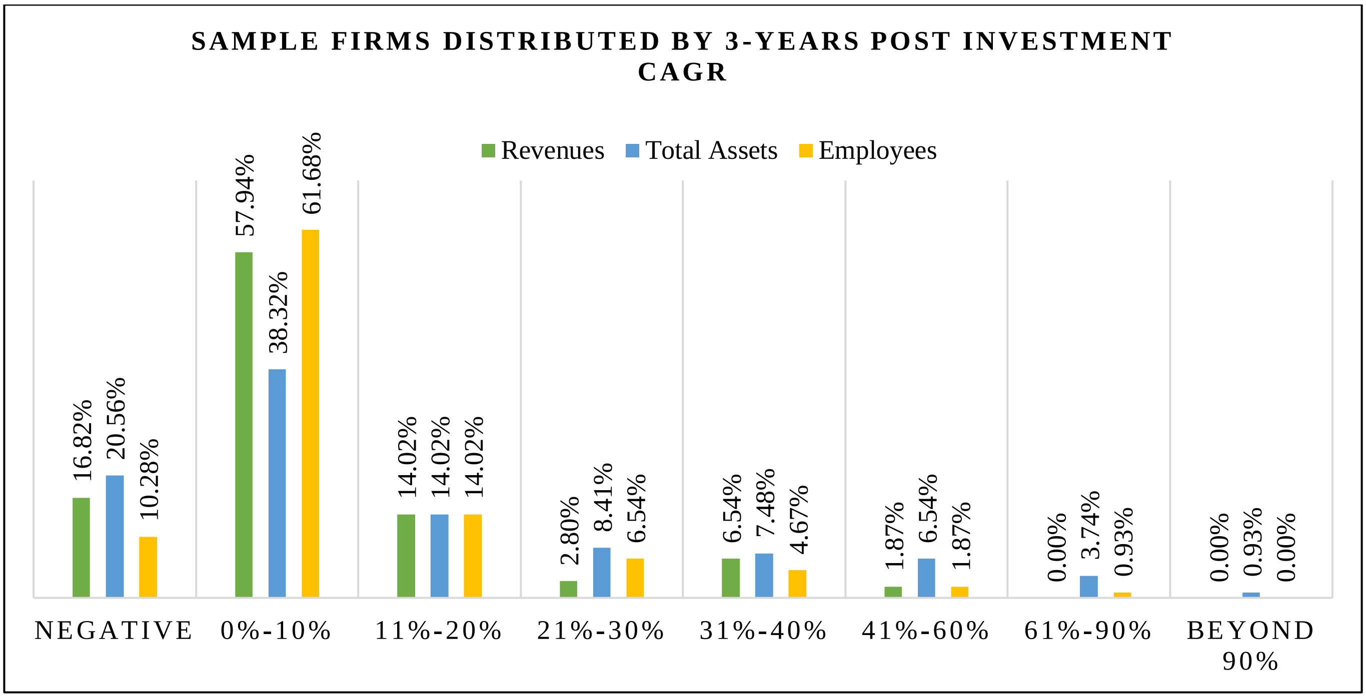

Chart 26. Source: Self-elaboration

On the other hand, in Chart 27, shown below, the growth rates of the income indicators are shown, in particular EBITDA and Net Profit.

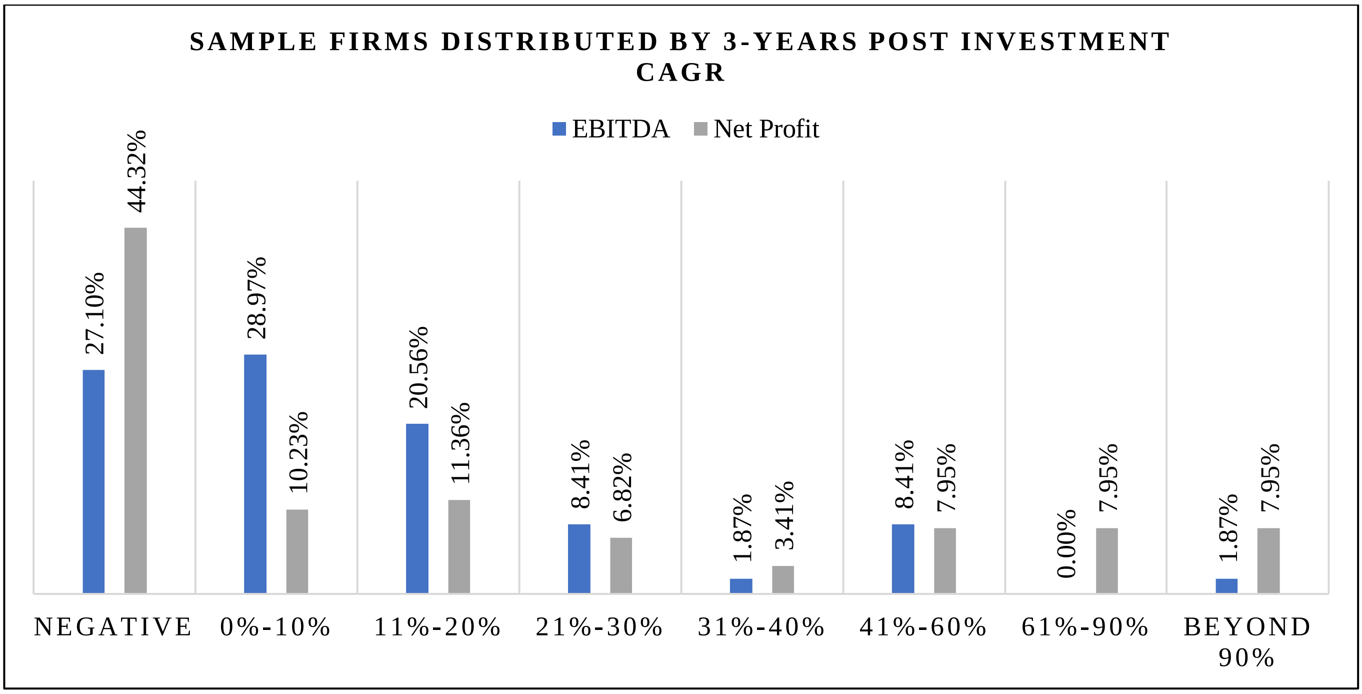

Chart 27. Source: Self-elaboration

In this case, the companies showing negative growth are higher than in the previous graph. As for the Net Profit, the companies that show an annual decrease in profit reach 44%, however, unlike the dimensional indicators, some companies have a very high Net Profit growth with about 15% of the companies attesting a CAGR exceeding 61%. EBITDA is distributed in a more homogeneous way, even if it is mainly concentrated in a CAGR of no more than 30%, and also in this case 27% of companies have a negative EBITDA CAGR.

The analysis of the sample consequently allows to highlight very different outcomes associated with the operations. It is therefore important to underline that there may also be criticalities within the relationship between private equity and target companies, without forgetting the positive evidence obtained during this analysis.

iii. Sample Analysis and Benchmark

The first analysis carried out on the sample concerns the involvement of two macroeconomic indicators, namely the Italian GDP and employment rate. To make a comparison between the trends of small and medium-sized enterprises invested by private equity operators, it was decided to take into consideration the average CAGR in the 2016-2019 four-years' time horizon (i.e., exactly the following three years compared to the investment date). Over the period, private equity-owned companies have continuously grown at a higher pace compared to the Italian market, both in terms of revenues and employment growth rate. In the following chart the comparison between GDP's CAGR and PE backed companies' revenues and EBITDA is displayed.

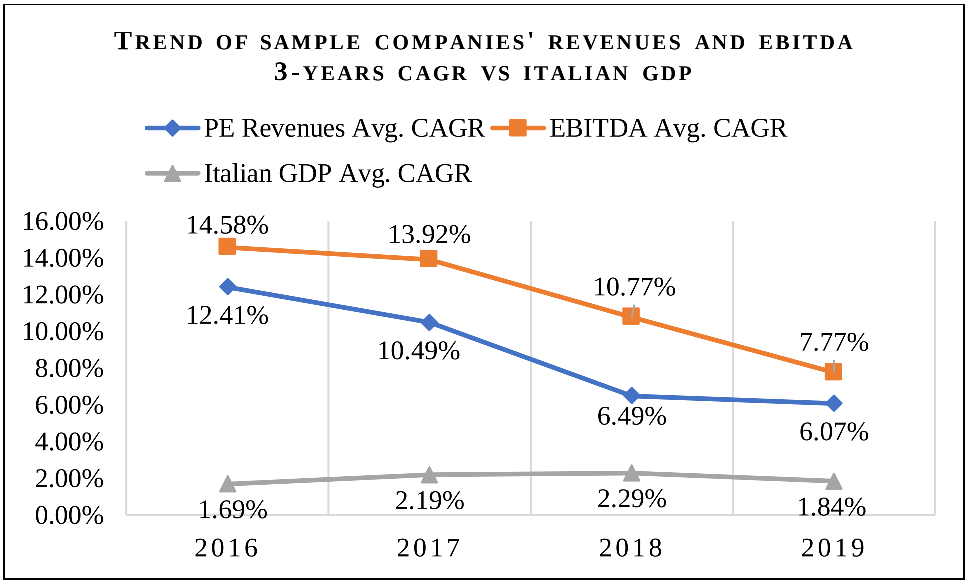

Chart 28. Source: Self-elaboration, Benchmark: ISTAT

Observing Chart 28, although the gap has progressively reduced from 2016 to 2019 period, the revenues and EBITDA growth of Private Equity backed firms have been steadily higher compared to the national GDP. In 2018 and 2019, while the Italian GDP remained almost flat, the EBITDA's average CAGR over the 2016-2019 period of PE portfolio companies shows a significant decrease compared to the previous years (about -3%). While such a decrease, in terms of Revenues' average CAGR, is shown only in 2018, in 2019 the variation remains relatively flat.

As mentioned above, the second macroeconomic indicator used as a benchmark for the sample refers to the employment rate. The following graph shows the different trends between the employment's average CAGR of PE-backed firms and Italian employment rates.

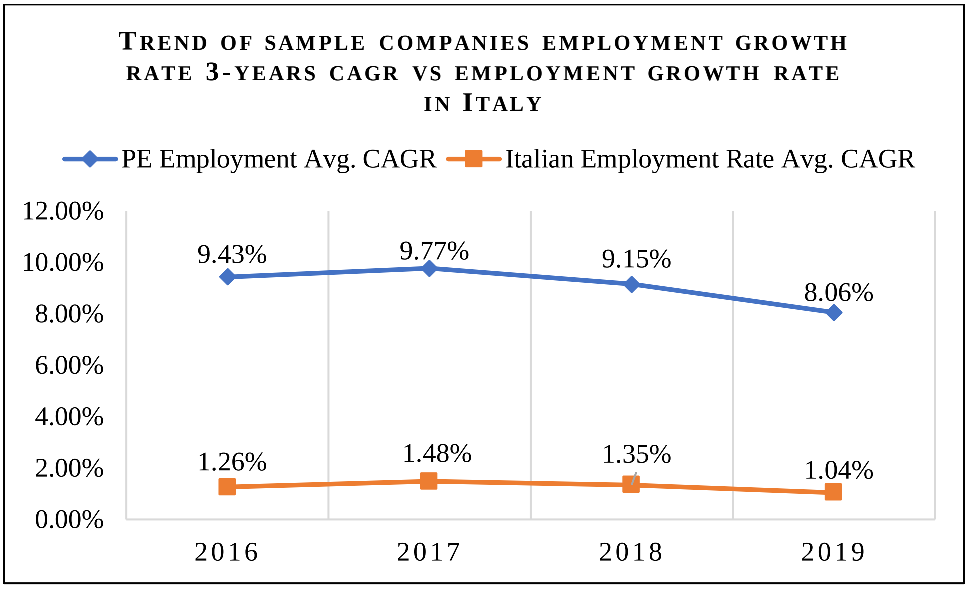

Chart 29. Source: Self-elaboration, Benchmark: ISTAT

The employment growth rate trend in Italy has shown a quite flat trend over the reference period, however highlighting a slight decrease ending in 2019 (about -0,4%). Over the same period, Private Equity backed SMEs have always kept a higher employment growth rate, constantly about 7% above the national rate.

The second benchmark to be analyzed is constituted by ISTAT data on the annual economic results of all Italian companies, hence including the ones not participated by a private equity fund. The database in question takes into account the performance and indicators of all Italian companies, for this reason it was necessary to filter these data by class of employees, taking into consideration only companies with a number of employees not exceeding 250, in order to include only SMEs. The period taken into consideration by this database goes from 2015 to 2018, hence the CAGRs on the various indicators used as benchmarks were calculated over a three-years' period, coinciding with the same time horizon as the analyzed sample.

In Chart 30 we can observe the difference in the revenues' average CAGR of PE backed companies compared to the ISTAT database.

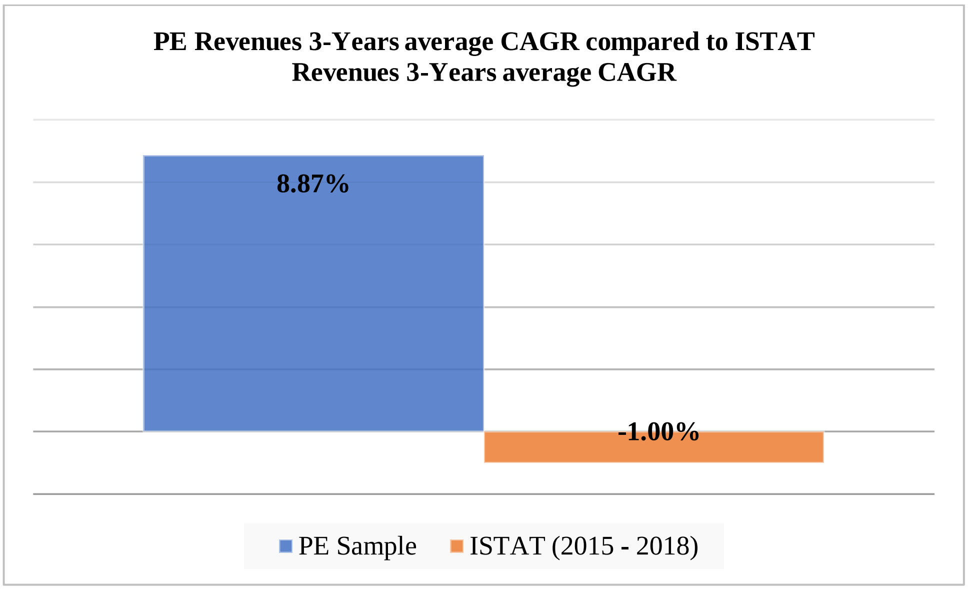

Chart 30. Source: Self-elaboration, Benchmark: ISTAT

Considering only small and medium-sized enterprises, up to a maximum of 250 employees, the ISTAT data show an annual negative turnover growth rate in the three-years' time horizon, with a value of approximately -1%, while the companies owned by private equity shows, in the three years following the investment, a positive turnover growth rate, much higher than the reference benchmark, for a total difference of 9,87 percentage points.

In the next graph, Chart 31, we can observe a similar comparison, taking into consideration EBITDA.

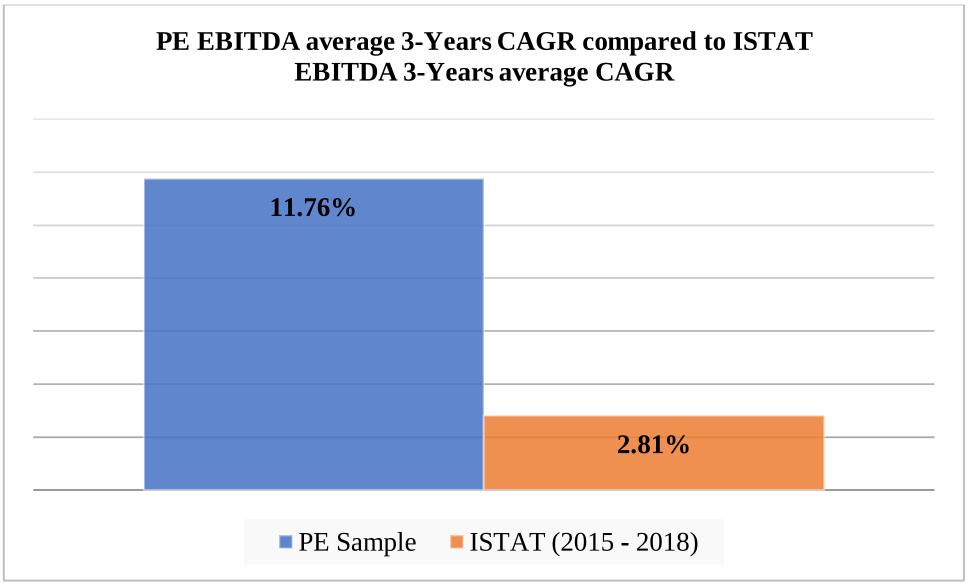

Chart 31. Source: Self-elaboration, Benchmark: ISTAT

In terms of EBITDA, the average CAGR of the sample amounts to 11,8%, while the reference benchmark, pointed out by ISTAT in a three-years' time horizon is about 2,8%. This trend is quite similar to the one observed in Chart 28. Also, in this case the PE backed firms have a much higher growth rate than the national average for small and medium-sized enterprises, with a difference of about 9 percentage points.

The last comparison worth exploring using the data provided by ISTAT is that of the growth in the employment rate. Chart 32 provides an analogous comparison to the ones analyzed before.

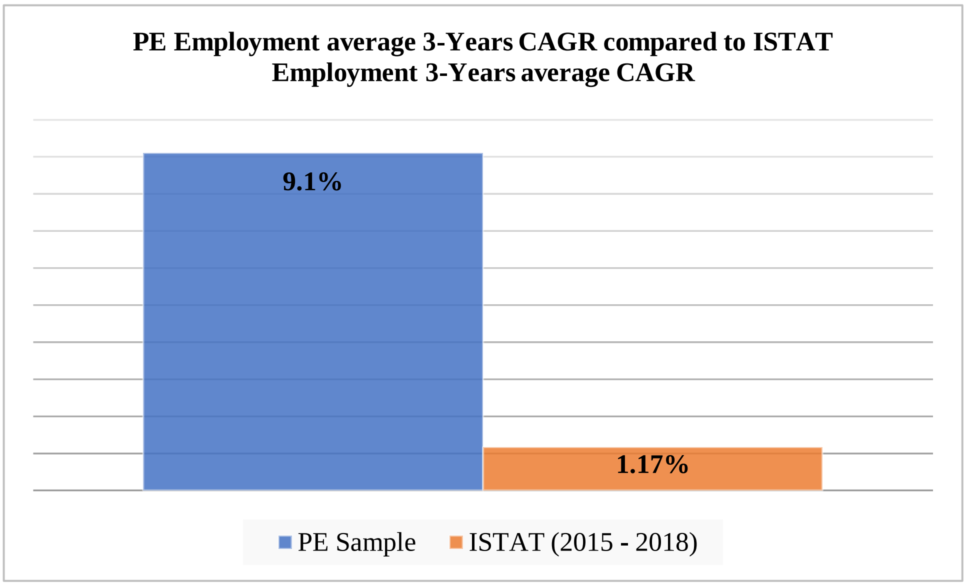

Chart 32. Source: Self-elaboration, Benchmark: ISTAT

As we can see, the trend perfectly mirrors that of Charts 28 and 29, in fact the companies invested by private equity operators, which have an average employment rate's CAGR of 9,1%, exceed the benchmark provided by ISTAT by almost 8 percentage points.

After comparing the data contained in the sample with those provided by the ISTAT databases, it was deemed necessary, in order to confirm these trends, to compare the sample also with further research. For this reason, the research carried out by Mediobanca and Unioncamere will be used, which analyzes Italian small and medium-sized industrial enterprises, for the period that goes from 2009 to 2018. Also in this case, the average CAGRs for each available indicator will be taken into consideration.

The data that the Mediobanca-Unioncamere research makes available are the annual averages, from 2009 to 2018, of the revenues, employment rate and total assets of Italian medium-sized industrial companies (turnover not exceeding 50 million euros), for a total of about 3,400 companies analyzed. To ensure homogeneity between the sample and the analyzed benchmark, it was decided to adapt the time horizon of data provided by Mediobanca-Unioncamere. For this reason, the period taken into consideration will be the one that goes from 2015 to 2018 (latest available data), therefore taking into account, also in this case, a time horizon for growth rates equal to three years.

The following graph, Chart 33, shows the evolution of the growth trend for each of these indicators over time.

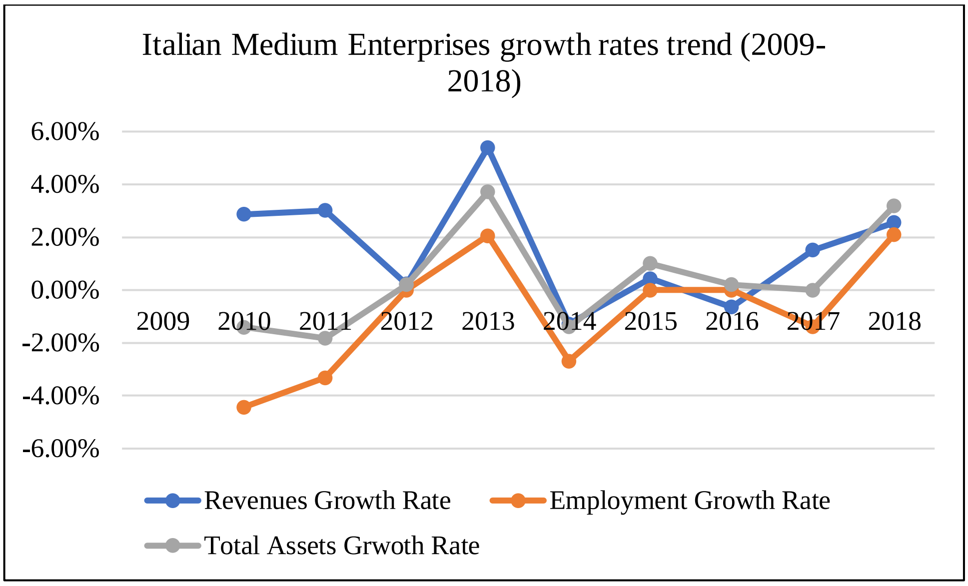

Chart 33. Source: Mediobanca-Unioncamere

As performed for the ISTAT data, the growth rates (3-Years CAGR) of these three available indicators, between 2015 and 2018, were compared with the average CAGRs detected by the sample. In Chart 34, the average revenues CAGR of the companies in the sample is compared with the one calculated using data provided by the Mediobanca-Unioncamere research.

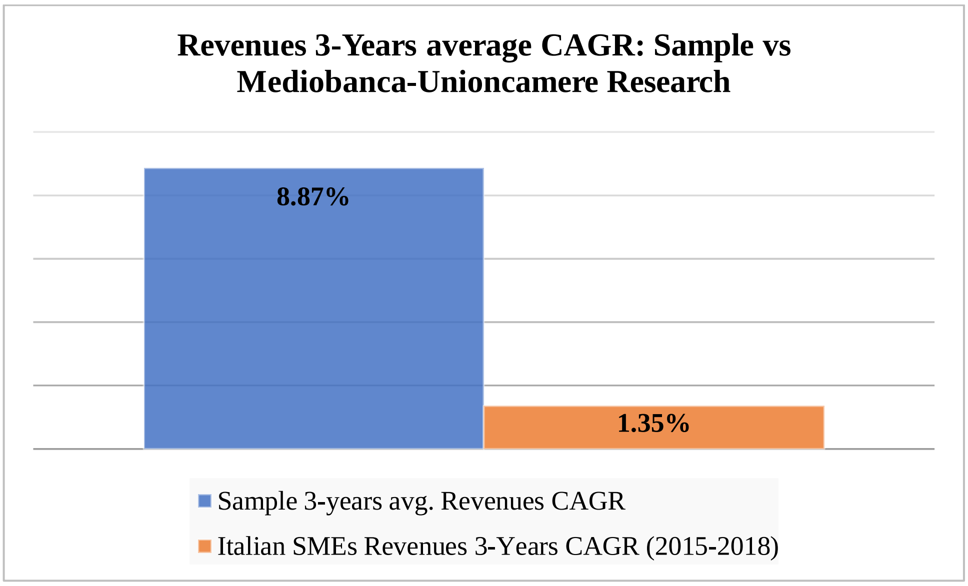

Chart 34. Source: Self-elaboration, Benchmark: Mediobanca-Unioncamere

Differently from the data found by ISTAT, which however also includes small and micro enterprises, the average annual growth of revenues measured by the benchmark is positive, but in any case, much lower than the CAGR recorded in the private equity backed companies analyzed. The difference, however, remains almost similar to that found by comparisons with other benchmarks.

If we take into consideration the data on the growth of the employment rate we see that, as shown by Chart 35, the CAGR detected by the benchmark is significantly lower (0,23%) for the analyzed years, the sample instead returns an employee growth rate of 9,1%, also in this case the data collected by ISTAT and Mediobanca-Unioncamere are very close to each other, and the difference with the sample is almost the same and is around 9-10 percentage points.

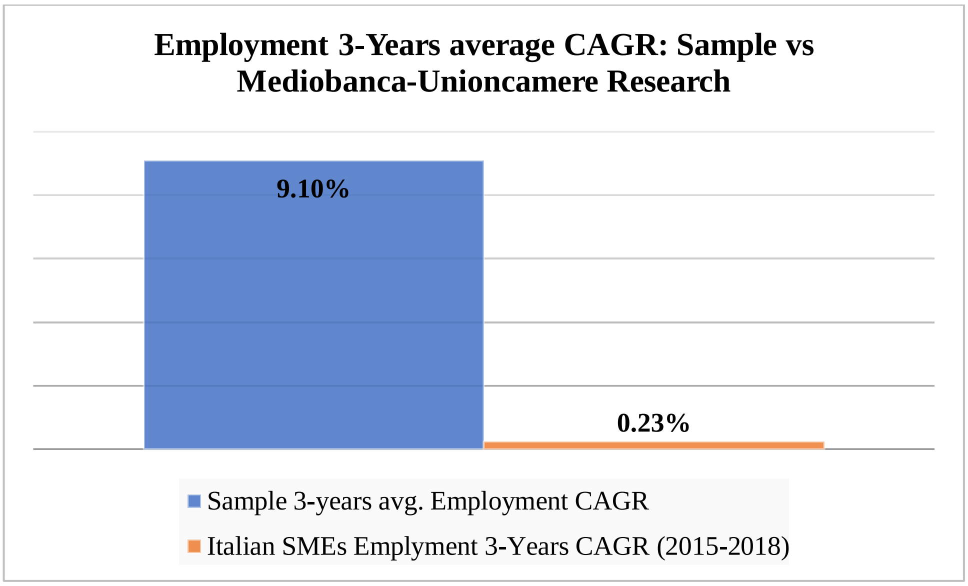

Chart 35. Source: Self-elaboration, Benchmark: Mediobanca-Unioncamere

Finally, the last indicator to be analyzed is that of total assets growth rate. Chart 36 provides, as before, the comparison between the sample and benchmark.

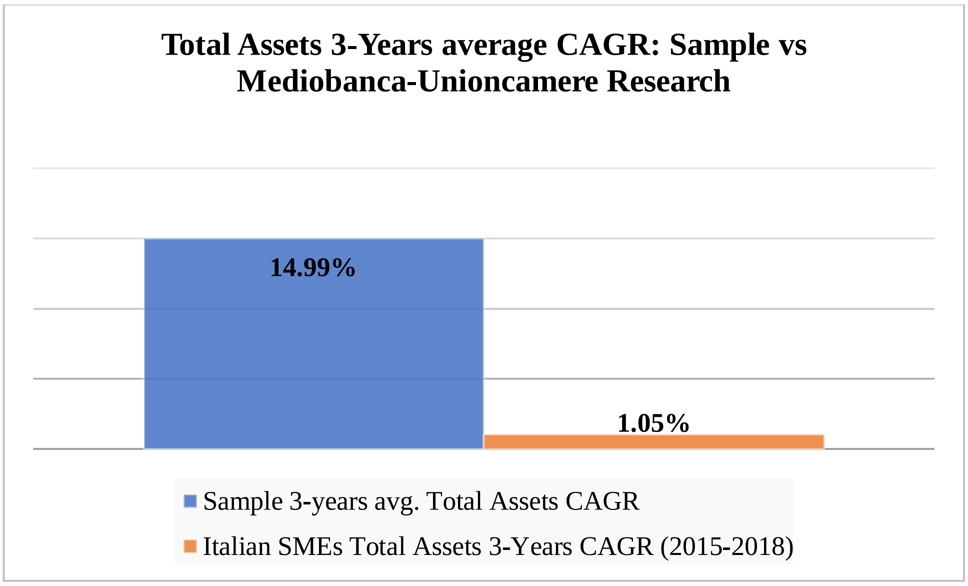

Chart 36. Source: Self-elaboration, Benchmark: Mediobanca-Unioncamere

In this case, the growth of total assets in companies owned by private equity operators (in the three years following the investment) is on average much higher (14,99%) than the growth of total assets recorded in Italian medium-sized industrial companies (1,05%), with a difference of approximately 14 percentage points.

As noted by the revision of the literature in chapter three, the impact of a private equity investment on target firms is significant and clearly visible. In this chapter, from an analysis conducted on 107 SMEs, identifying macroeconomic indicators, ISTAT data and the research carried out by Mediobanca-Unioncamere as the main benchmarks, the performance of companies invested by a private equity operator is much higher both for as regards the growth of both dimensional and income indicators. It is therefore necessary to keep in mind the reflection carried out in the initial stage, where it was pointed out that the collaboration between institutional investor in venture capital and small and medium-sized enterprises has clearly had an extremely positive impact on the growth process of investee companies. This empirical evidence confirms what was stated in the introduction, namely that private equity contributes to the growth of target companies through financial support, but also thanks to a qualitative contribution that allows them to expand the horizons of the companies themselves.

However, this is not always the case. After carrying out an analysis by comparing the average data collected in the sample with those observed in the reference benchmarks, it was deemed appropriate to investigate the impact of private equity on the target companies themselves, comparing the performance trends before and after the investment (taking into consideration the three previous and three subsequent years).

The main objective of this last step is to actually ascertain whether, as stated by some research in the literature[86], private equity has a significant and clearly visible impact compared to the pre-investment period, or whether private equity companies only select firms that already have high growth rates, helping only to accelerate or maintain the performance of companies that are already growing.

To do this, the data relating to the three years preceding the investment were collected following the same methodology and the same principle as the post-investment data collection. the graphs that will be proposed will analyze, for each indicator considered, the annual growth (in the form of CAGR) of the following three years and of the three years preceding the investment year (respectively t + 3 and t + 1). In addition to this, the total averages of the years considered will be also indicated in the charts.

Before proceeding with the above-mentioned analysis, it was decided to carry out comparisons within the sample using relevant sub-samples, in order to understand if, differentiating for certain investment

[86] F. Buttignon, M. Vedovato, P. Bortoluzzi, V. Casarin, *L'impatto dei private equity sulle performance delle imprese familiari: il caso italiano*, e&m 2, 2009.

criteria, the performance after the investment changed significantly. For this purpose, three criteria were used to divide the sub samples: dimensional criteria, separating target firms that have more than 50 employees (however less than 250) and companies that have less than 50 employees (thus dividing between medium companies and small and micro companies); investment type criteria, separating buy-outs investments from growth capital investments; acquisition stake criteria, separating majority form minority investments. In addition, both one-tail and two-tail T-test were applied to the following sub-sample. The T-test is a parametric statistical test with the objective of verifying whether the mean value deviates significantly from a certain reference value. In this context, the T-test is used to evaluate the comparison between two average values. To determine whether the differences between averages are significant and not related to chance, first we have to look to the column Sig. (significance), if this value is less than or equal to 0,05, we need to consider the value of t associated with the "Do not assume equal variances" row. On the other hand, if Sig. is higher than 0,05, we need to consider the "Assume equal variances row". Furthermore, we have to consider the Sig. (one-tail) and Sig. (two-tails) values to assess whether there are significant differences. If those values are less than or equal to 0,05, the average values are considered significantly different.

Table 7 shows the three-years average CAGR differences between medium (> 50 employees) and small and micro enterprises (≤ 50 employees).

	Av. Performance Medium Firms (> 50 employees)	Av. Performance Small and Micro Firms (≤ 50 employees)		**Test of equality of variances**		**Equality T-test of variances**			
				F	Sig.	t	Sig. (one-tail)	Sig. (two-tails)	Difference between averages
Revenues 3Y CAGR	7,70%	8,80%	Assume equal variances	0,7715	0,1926	-0,4507	0,3266	0,6531	-0,0108
			Do not assume equal variances			0,2245	0,4118	0,8236	-0,0108
EBITDA 3Y CAGR	9,90%	10,90%	Assume equal variances	1,6828	0,0327	-0,2038	0,4194	0,4245	-0,0102
			Do not assume equal variances			-0,1911	0,8389	0,8490	-0,0102
Net Profit 3Y CAGR	10,30%	10,20%	Assume equal variances	0,5921	0,0570	0,0108	0,4957	0,4954	0,0011
			Do not assume equal variances			0,0115	0,9914	0,9908	0,0011
Total Assets 3Y CAGR	11,60%	13,90%	Assume equal variances	1,6448	0,0370	-0,6178	0,2690	0,2817	-0,0229
			Do not assume equal variances			-0,5806	0,5380	0,5635	-0,0229
Employees 3Y CAGR	7,70%	9,90%	Assume equal variances	0,8366	0,2770	-0,8507	0,1984	0,1933	-0,0220
			Do not assume equal variances			-0,8702	0,3968	0,3865	-0,0220

Table 7. Source: Self-Elaboration on Sample data, provided by AIDA. The table shows the average performance of Medium Firms (70 observations) and Small and Micro Firms (37 observations).

As we can observe, in terms of averages, the differences between the two sub-samples are subtle. Overall, considering the sample target firms, data shows that small and micro companies record a slightly better performance for almost all indicators, in the three years subsequent to the investment. The applied T-Tests state that there is not significant difference between the average CAGR of the two sub-samples. The tests therefore affirm that the hypothesis according to which there is no significant difference between the averages of the performances of medium and small enterprises cannot be rejected.

The next table shows a similar analysis conducted considering buy-outs and growth capital investments as sub-samples. Also, data reported in table 8, do not identify a significant difference between the indicators calculated on buy-out and growth capital investments, although slightly better average results are recorded by buy-out operations.

	Av. Performance Buy-Out Operations	Av. Performance Growth Capital Operations		Test of equality of variances		Equality T-test of variances			
				F	Sig.	t	Sig. (one-tail)	Sig. (two-tails)	Difference between averages
Revenues 3Y CAGR	8,10%	8,90%	Assume equal variances	0,7531	0,1623	-0,3141	0,3770	0,7541	-0,0080
			Do not assume equal variances			-0,2958	0,3843	0,7686	-0,0080
EBITDA 3Y CAGR	11,70%	10,30%	Assume equal variances	1,0888	0,4106	0,2578	0,3986	0,7971	0,0142
			Do not assume equal variances			0,2625	0,3970	0,7939	0,0142
Net Profit 3Y CAGR	12,10%	10,60%	Assume equal variances	1,7350	0,0618	0,5448	0,2937	0,5873	0,0544
			Do not assume equal variances			0,1341	0,4469	0,8938	0,0544
Total Assets 3Y CAGR	13,70%	11,80%	Assume equal variances	0,6627	0,0778	0,8930	0,1869	0,3739	0,0410
			Do not assume equal variances			0,3849	0,3511	0,7023	0,0410
Employees 3Y CAGR	9,10%	8,80%	Assume equal variances	1,7020	0,0529	0,1358	0,4461	0,4399	0,0037
			Do not assume equal variances			0,1517	0,8922	0,8798	0,0037

Table 8. Source: Self-Elaboration on Sample data provided by AIDA. The table shows the average performance of Buy-Out Operations (76 observations) and Growth Capital Operations (31 observations).

The result obtained from the T-tests, in table 8, therefore states that there are no significant differences, in terms of performance growth, between a buy-out investment and a growth capital investment. This result reflects the operating mechanism of most private equity funds. That is, regardless of the type of operation carried out, the quantitative and qualitative contribution within the target company does not change significantly between one type of operation and another.

	Av. Performance Majority Acquisitions (> 50% stake)	Av. Performance Minority Acquisitions (≤ 50% stake)		Test of equality of variances		Equality T-test of variances			
				F	Sig.	t	Sig. (one-tail)	Sig. (two-tails)	Difference between averages
Revenues 3Y CAGR	8,40%	8,30%	Assume equal variances	0,9614	0,4299	0,0561	0,4777	0,9554	0,0150
			Do not assume equal variances			0,0555	0,4780	0,9560	0,0150
EBITDA 3Y CAGR	10,30%	9,00%	Assume equal variances	1,5667	0,0996	0,2700	0,3938	0,3824	0,0130
			Do not assume equal variances			0,3007	0,7877	0,7648	0,0130
Net Profit 3Y CAGR	12,00%	10,80%	Assume equal variances	1,4906	0,1493	0,0968	0,4616	0,4578	0,0113
			Do not assume equal variances			0,1064	0,9231	0,9157	0,0113
Total Assets 3Y CAGR	13,40%	9,10%	Assume equal variances	1,2351	0,2773	1,0594	0,1459	0,1348	0,0434
			Do not assume equal variances			1,1166	0,2919	0,2696	0,0434
Employees 3Y CAGR	9,60%	7,40%	Assume equal variances	1,9423	0,0293	0,7603	0,2244	0,1875	0,0219
			Do not assume equal variances			0,8934	0,4488	0,3751	0,0219

Table 9. Source: Self-Elaboration on Sample data provided by AIDA. The table shows the average performance of Majority Acquisitions (80 observations) and Minority Acquisitions (27 observations).

The trend observed in table 8 also finds some correspondence in table 9, where investments involving majority acquisitions are differentiated from minority acquisitions. Again, despite the subtle difference in favor of majority investments, the T-tests do not report the means as significantly different form each other. The data shown in table 9 faithfully reflect those of table 8 as buy-out investments mostly refer to acquisitions exceeding 50% of the target company while growth capital operations usually involve minority acquisitions.

This result may very likely have arisen above all from the fact that the sample contains an insignificant number of minority investments of less than 25% (8 observations). In fact, in these cases the average performances recorded in the three years following the investment are significantly lower than the average restated for each indicator. On the other hand, minority investments with an acquisition of more than 25% of the company and majority investments report results that are similar, with minimal deviations. The private equity fund aims to obtain a substantial capital gain from the sale of the acquired shareholding. for this reason, the funds generally prefer a majority acquisition or, in any case, very close to 50%. With a majority stake in the company, an investor is incentivized to prioritize the business' strategic growth and ensures its operational approach is aligned with the business strategy from the start of the relationship. When a firm is more focused on a company's long-term success, intellectual capital provides exposure to outside expertise and best practices.

After having highlighted that, considering different sub-sets of the sample, the average growth rates are mostly similar and there are no significant statistical differences, the next step is to compare the performance of these companies before and after the investment, with the aim to identify any significant differences in the growth rates of the indicators.

The first graph that is proposed is the one relating to annual revenue growth, Chart 37.

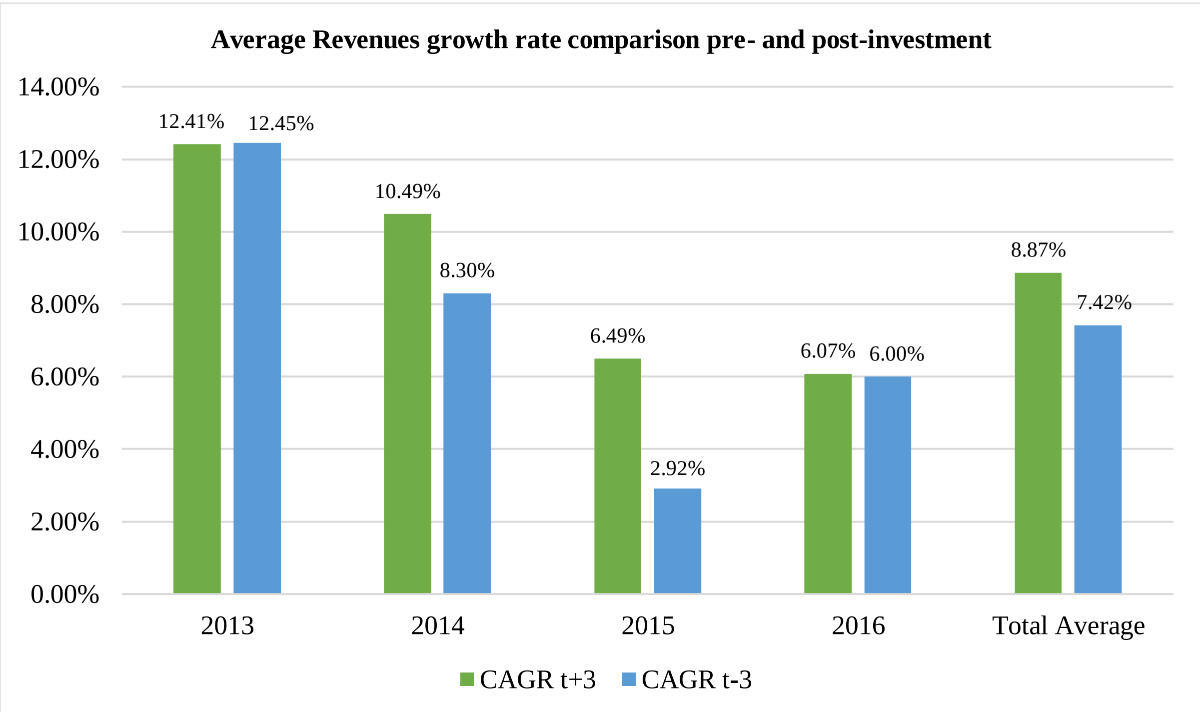

Chart 37. Source: Self-elaboration.

As we can see from the graph above, the growth in revenues is not particularly different between the pre- and post-investment period, with the sole exception of the investments made in 2015 which show a significantly higher rate of revenue growth in the post-investment period. The total average in the three years following the investment is therefore only 1,45 percentage points higher. In the next graph, Chart 38, data related to EBITDA growth rates are presented.

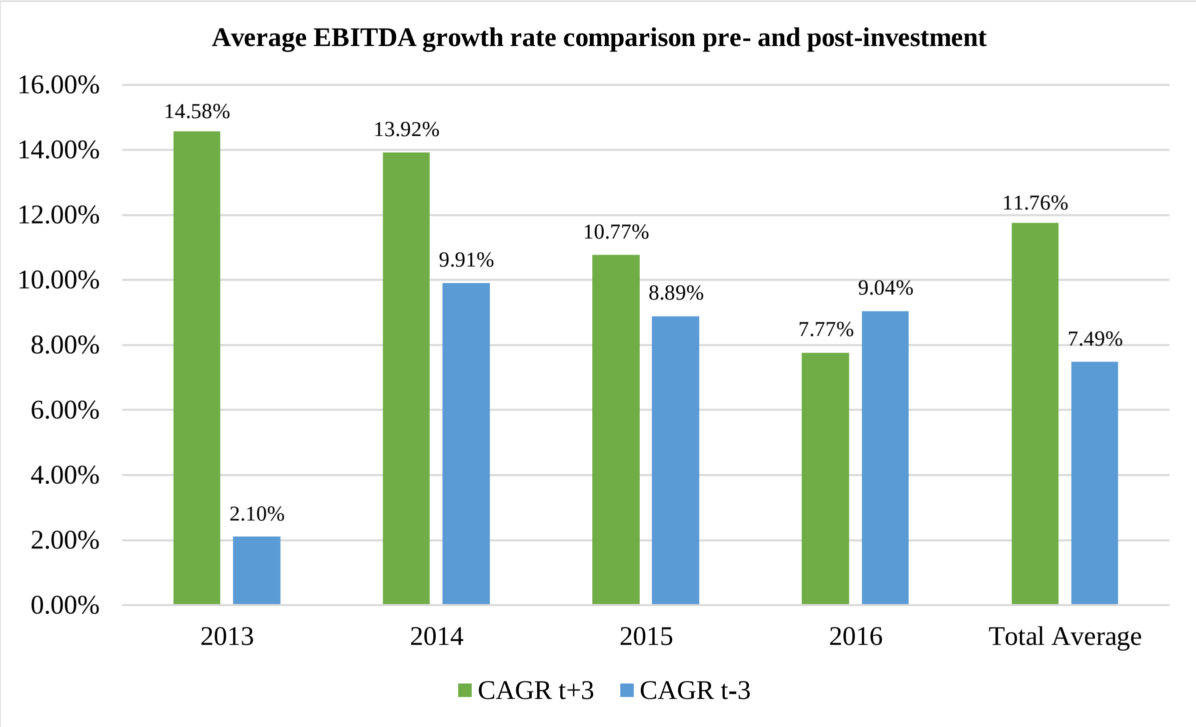

Chart 38. Source: Self-elaboration.

The data recorded on the EBITDA growth rates of the small and medium-sized enterprises analyzed show trends similar to those of revenues, however with some anomalies. First of all, the investments made in 2013 show a much higher CAGR of post-investment EBITDA (approximately 12%) compared to the pre-investment years. The other periods present data very similar to those found in graph 37, however the investments made in 2016 show a post-investment CAGR slightly lower than the pre-investment CAGR. Overall, the total average still indicates a higher post-investment CAGR of around 4%, thus confirming the positive impact of the investment despite the excellent growth recorded in the previous three years.

In the next chart, Chart 39, the data relating to the Net Profit will be observed.

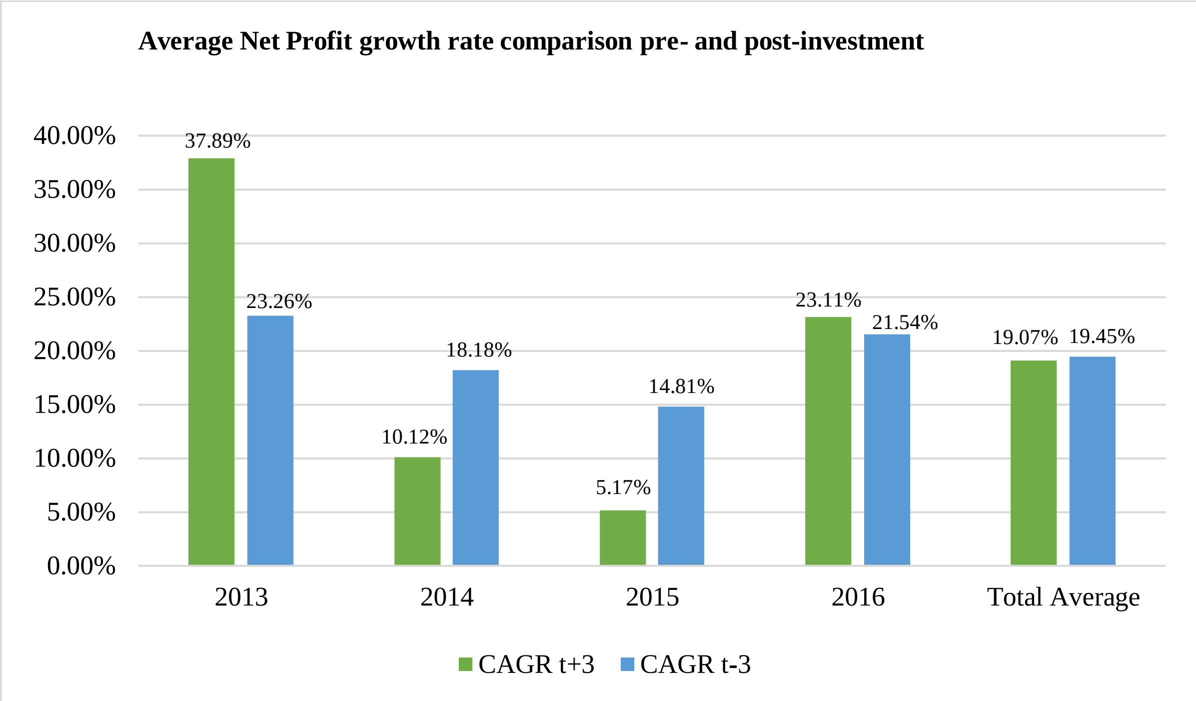

Chart 39. Source: Self-elaboration.

By observing the graph relating to the Net Profit, we can observe how the growth rates in the four reference periods behave significantly differently from those recorded in the previous graphs. The growth rates are very high compared to Revenues and EBITDA, with a post-investment average in 2013 of almost 40 percentage points. In 2014 and 2015, however, post-investment data was much lower than pre-investment data, confirming the fact that in those years, the intervention of a private equity operator did not have a positive impact. Overall, the total average post-investment CAGR is slightly lower, by around 0,40%, compared to the pre-investment average, so the growth rate remained substantially unchanged before and after the investment.

Chart 40, shown below, represents average annual growth rates of the dimensional parameter relating to total assets.

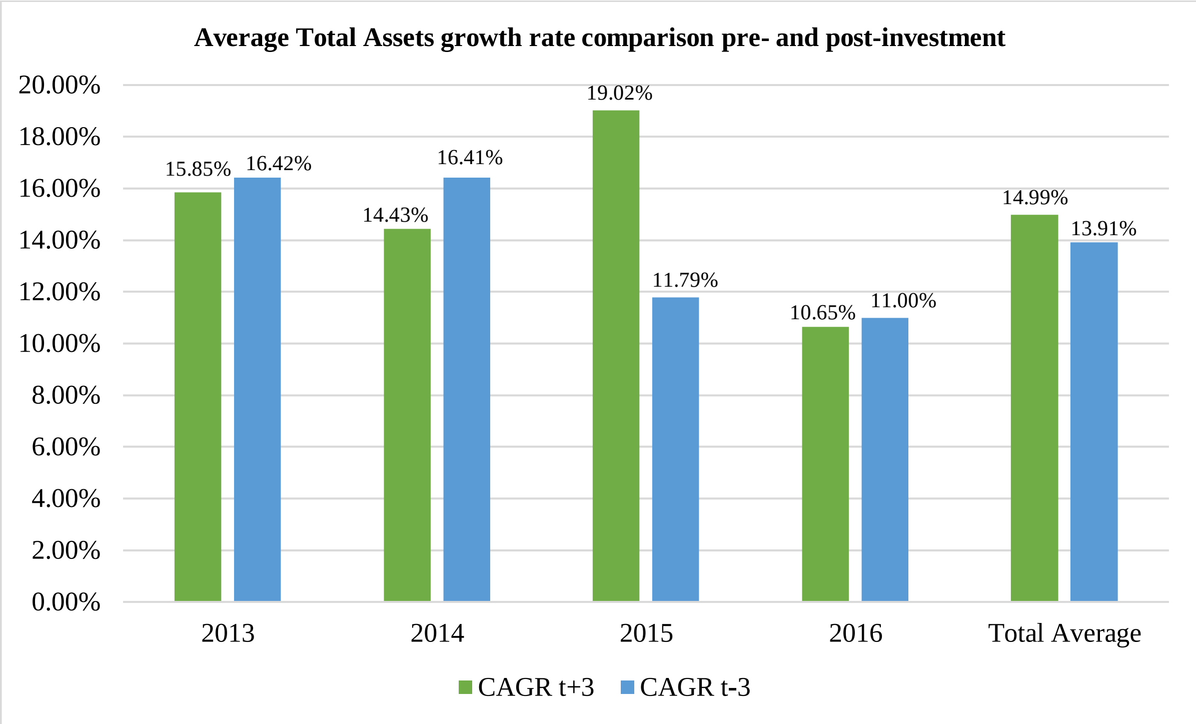

Chart 40. Source: Self-elaboration.

From graph 40, we note that the CAGRs relating to the total assets of the target companies are essentially very similar between the pre- and post-investment period. The only significant difference is represented by the investments made in 2015, where the post-investment growth rates exceed those pre-investment by approximately 7 percentage points. Overall, the total averages are high both pre and post investment but in any case, they do not differ significantly from each other (about 1% difference). A relevant aspect is also represented by the fact that the investments that took place in the other periods (2013, 2014 and 2016) show lower growth rates in the post-investment period, therefore the total average is greatly influenced by the year 2015, without which the average growth rate of total assets would be slightly lower in the three years following the investment.

Finally, the last graph, Chart 41, which is worth analyzing is the one relating to another dimensional parameter, namely the growth of employees of the target small and medium-sized enterprises in the reference periods.

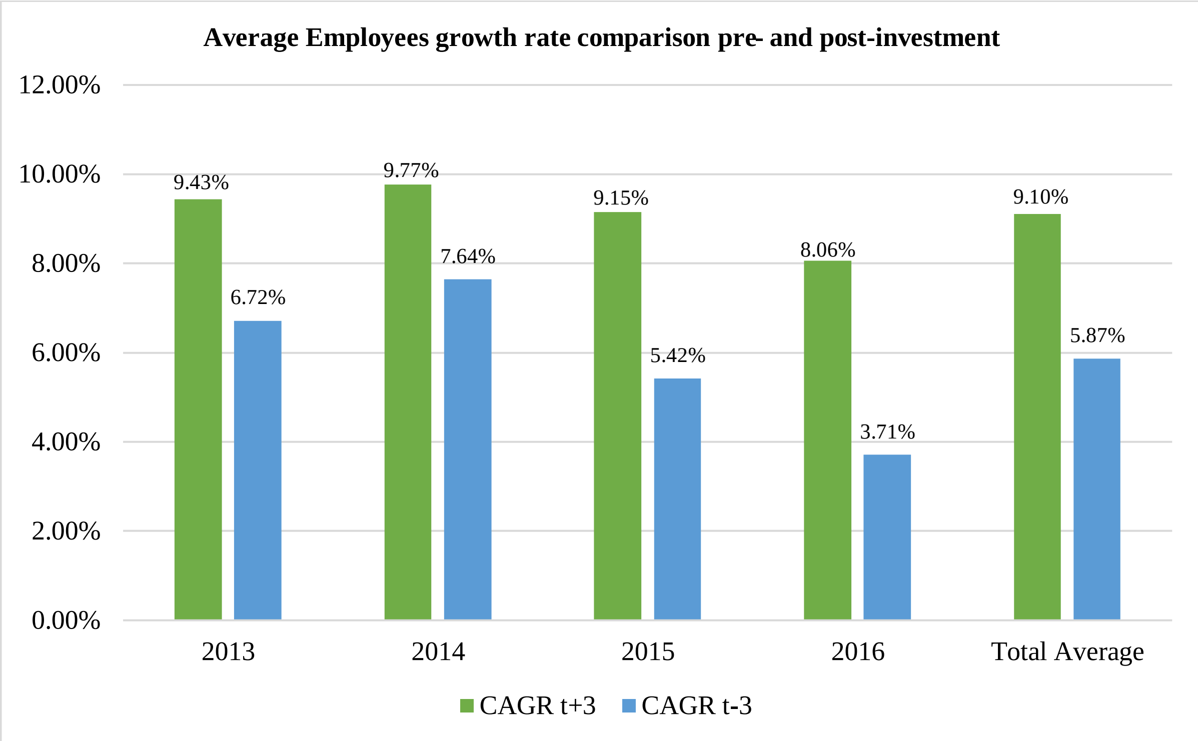

Chart 41. Source: Self-elaboration.

Graph 41, which compares the pre- and post-investment CAGRs relating to employees, shows a clear difference, compared to the other graphs, between the data before and after the private equity operator entered the company. In this case, the investment has a significant, evident and homogeneous impact in all four periods analyzed, with the total average differing by approximately 3 percentage points more than in the three years prior to the investment.

At the end of the proposed analysis, to summarize the main data, it is necessary to prepare the following table, containing the total averages of the analyzed indicators in the three years before and after the investment.

				Test of equality of variances		Equality T-test of variances			
	Av. Performance Post-Investment	Av. Performance Pre-Investment		F	Sig.	t	Sig. (one-tail)	Sig. (two-tails)	Difference between averages
Revenues 3Y CAGR	8,87%	7,42%	Assume equal variances	1,0125	0,4754	1,0258	0,1531	0,3062	0,0169
			Do not assume equal variances			1,0259	0,1531	0,3061	0,0169
EBITDA 3Y CAGR	11,76%	7,49%	Assume equal variances	0,9080	0,3141	0,7853	0,2166	0,2169	0,0287
			Do not assume equal variances			0,7844	0,4332	0,4337	0,0287
Net Profit 3Y CAGR	19,07%	19,45%	Assume equal variances	0,9451	0,3967	-0,1188	0,4528	0,9056	-0,0100
			Do not assume equal variances			-0,1188	0,4528	0,9056	-0,0100
Total Assets 3Y CAGR	14,99%	13,91%	Assume equal variances	1,0941	0,3243	0,4739	0,3180	0,6361	0,0138
			Do not assume equal variances			0,4743	0,3179	0,6358	0,0138
Employees 3Y CAGR*	9,10%	5,87%	Assume equal variances	1,5658	0,0117	2,0709	0,0198	0,0396	0,0335
			Do not assume equal variances			2,0797	0,0194	0,0388	0,0335

Table 10. Source: Self-Elaboration on Sample, data provided by AIDA. The table shows the average post-Investment (107 observations) and pre-Investment (107 observations) performance.
** Both one-tail and two-tails T-Tests, only regarding the Employees three-years CAGR, are significant for $p \leq 0{,}05$.*

Overall, in table 10, we can observe that the T-tests carried out on the selected samples, in general, do not affirm significant differences between the pre-investment and post-investment averages. This result could be mainly due to some limitations within the sample. One cause, in addition to the small size of the sample comprising 107 observations, could be due to the fact that the database considered does not differentiate the analysis between different sectors. As a private equity investment brings not only a financial contribution but also an endowment of know-how and expertise, the fact that the database contains more than one investment sector could prevent the recognition of a significant difference in performance before and after the investment period.

Results, however, show how the two types of companies differ with reference to the average Employees three-years CAGR ($t= 1,5658$; $p \leq 0,05$). This finding is coherent with the main results provided by an already mentioned EVCA research paper which reveals that private equity and venture capital play a vital role in the conservation and creation of employment at a European level. The research in question highlights that employment grew by an average rate of 5,4% annually over the period between 2000 and 2004, this data is reasonably comparable to what is reported in table 10, since the research also takes into consideration venture capital operations, which have an average performance lower than private equity.[87]

In conclusion, we can say that, comparing the averages, the compound annual growth of target firms after the investment is slightly higher than in the previous period. However, these differences are not overwhelming, except for the rate of employment growth which is significantly higher in the subsequent period.

iv. Discussion of results

From the empirical research proposed in chapter four, several conclusions can be drawn. First of all, it is important to underline how by comparing the data on Italian SMEs subject to private equity investment with the benchmarks illustrated in the introduction phase, the skills and resources provided to the target companies favor a much higher growth of the invested company compared to the average recorded by the macroeconomic indicators, ISTAT and Mediobanca-Unioncamere databases. In fact, as supported by provided data, companies that are subject to private equity investments have significantly higher CAGR in size and performance than non-investee companies.

The results found, albeit deriving from analyzes carried out only on small and medium-sized Italian companies, are fairly consistent with the Italian and international literature proposed in chapter three, that is, despite some situations in which private equity investment has contributed negatively to the company's growth, the vast majority of investments had a positive impact on the target company. As

[87] EVCA Research Paper, *Employment contribution of Private Equity and Venture Capital in Europe,* November 2005.

shown by the data, most of the invested companies manifest a positive, albeit small, growth of the analyzed indicators, with some exceptions in which companies experience strong annual growth rates in the three years following the investment.

The ultimate goal of the work, however, in addition to verifying and confirming what is expressed in past literature, is to understand whether the change in the annual growth rates of the proposed dimensional and performance indicators is significant and relevant compared to the growth recorded in the same time frame, in the period prior to the investment.

As we noted in the final part of the analysis, taking into consideration the total averages, we observe an improvement in growth rates in the period following the investment for all indicators except for the Total Assets' CAGR, for which post-investment growth is slightly lower than pre-investment growth. However, the gap recorded in the two periods is not particularly significant, in fact the biggest differences are recorded in the employment growth rate, around 3%, and in the EBITDA growth rate, around 4%. This suggests that private equity firms, on average, excluding turnaround operations, usually target small and medium-sized enterprises that already have rather high growth rates, or at least fairly above average. The only exception in which the difference between the growth rates is statistically significant is that concerning the employment rate, which is significantly higher in the period following the investment by a private equity fund.

Overall, the characteristic highlighted by the provided data is in line with the type of strategy that is adopted by private equity companies in the investment research phase. In fact, private equity is not for all types of companies. Their mission is to invest in firms (with a majority or minority stake), create value during a period of approximately four or five years and then sell their share with the greatest capital gain possible. Therefore, they look for businesses that show clear growth potential in sales and profits over the following years. Once invested, private equity's profits will depend on the growth and profitability of the target firm. For this reason, as confirmed by the data, the impact of the investment by a private equity operator lies not so much in significantly improving the performance of the target company, but rather, in maintaining, and in some cases accelerating, high growth rates already belonging to the target firms, in such a way as to be able to have the highest possible return on divestment.

Conclusions

Private equity, born at the beginning of the last century in the United States, is today a consolidated reality also in Europe, but in Italy, although the successful cases are numerous and constantly growing, it has not yet had the development that one would expect, given the advantages it presents compared to some forms of traditional credit. In fact, unlike a bank loan, with its pre-established repayment terms of capital and interest and totally detached from the results of the company, it is a "patient capital", an investment, by the private capitalist who awaits the opportune moment for its exit, represented by the divestment through the sale of its shares, which are often repurchased by the investee company, or offered to the market upon its entry on the stock exchange. It is an investment that can last, on average from 5 to 10 years, but can have an even longer time horizon.

At the end of the proposed research, it is possible to affirm that, in general, the entry of a private equity fund into the share capital of a target enterprise positively influences the economic and financial performance of the investee company. This emerged both when the theoretical part was treated, and also when the empirical analysis was performed in the fourth chapter.

In fact, for the company, the entry of a fund represents not only a contribution of capital but also a contribution of skills, of know-how transfer, of help in management, of exploitation of the network of contacts that the fund has. The relationship that is formed between investor and company is undoubtedly to be considered win-win, since the fund actively strives to ensure that the investee company increases its value. The more this value increases, the more the capital invested by the fund will be remunerated.

Observing the studies carried out in the document produced by Frontier Economics in 2013, we can see how, at an international level, most of the research attributes to private equity firms a decidedly positive impact on target companies, supporting them by increasing the level of innovation, of productivity, internationalization, and expertise. Also in Italy, from the research analyzed, it is believed that private equity represents, for Italian companies, an option to be taken into consideration; also, in the light of an entrepreneurial system characterized for the most part by small and medium-sized enterprises, undercapitalized, family-owned, poorly managed and grappling with the challenges deriving from globalization.

The empirical analysis realized in the last chapter therefore aims, first of all, to seek confirmation of what was stated in the literature review, regarding the positive effect, in quantitative terms, that private equity delivers on companies' performance once the investment has been made. Secondly, it has the purpose of investigating whether the growth recorded is actually significantly determined by the entry of the fund into the share capital of the target company, or whether this growth was already present in the years prior to the investment, thus attributing to a certain extent to the private equity operator the merit of a sudden growth of economic-financial indicators, instead recognizing the ability to select companies that already have a high and constant annual growth rate and therefore, to maintain this trend even after the investment.

As regards the first objective set by the empirical analysis, the results obtained are definitely positive and confirm what has been observed in the literature. The analysis was carried out on a sample of 107 small and medium-sized Italian companies invested between 2013 and 2016. By examining the annual growth rates in the three years following the investment, we note that the vast majority of companies in the sample present a clearly positive CAGR for all the indicators analyzed (Revenues, EBITDA, Net Profit, Total Assets, Employment rate). On the other hand, with the exception of Net Profit, the number of companies whose indicators show a negative CAGR in the three years following the investment are negligible. After having outlined and analyzed the sample in detail, the data were compared with three benchmarks, in order to seek a comparison with a sample of companies not involved in private equity investments. The adopted benchmarks were: two main macroeconomic indicators, hence Italian GDP and Employment growth rates; the ISTAT database, which collects data on all Italian companies broken down by number of employees between 2015 and 2018; the Mediobanca-Unioncamere database, which collects data on all Italian small and medium-sized industrial enterprises between 2009 and 2018. The analysis showed that the growth rates of small and medium-sized enterprises subject to investments are much higher than those provided by the reference benchmarks containing non-investee companies.

At first sight, therefore, it would seem that the collaboration between the private equity investor and the small-medium enterprise has had an extremely positive impact in the growth process of the target. For this reason, in the second part of the analysis, it was decided to compare the data from the three financial statements before and after the investment of the companies observed in the sample. The results of this analysis show how, following the investment, the growth rates of the analyzed indicators are on average higher than those recorded in the pre-investment period. Only the Net Profit records on average a lower growth rate than in the period prior to the investment.

However, the differences between the periods before and after the entry into the share capital by the private equity operator are not overwhelming, on the contrary, the percentages, on average, are very close to each other, with the only exception of employment growth rate which results statistically significantly higher in the period subsequent to the investment. Therefore, the conclusion deriving from this analysis, while confirming the positive role of private equity as a support for the creation of value for the company, which goes beyond the mere contribution of financial resources, also confirms the widespread opinion according to which private equity does not significantly change the previous trends of acquired companies, but rather helps to maintain or even accelerate the performance of companies that already have high and constant growth rates[88].

[88] F. Buttignon, M. Vedovato, P. Bortoluzzi, V. Casarin. *L'impatto dei private equity sulle performance delle imprese familiari: il caso italiano*, e&m 2, 2009.

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Summary

Introduction

Over the last decades the Private Equity industry has developed into an important component of corporate finance. The objective of the following paper is to offer an overview, as exhaustive as possible, of the universe of Private Equity, trying to understand, through an empirical study, the real impact that Private Equity investments have on small and medium-sized enterprises subject to investment, within in the Italian market.

The first chapter aims to frame the phenomenon of Private Equity, defining its characteristics and limits in detail, differentiating it from other similar forms of investment included in the Private Capital universe, such as Venture Capital and Private Debt. The chapter deals with various relevant aspects, such as the definition and sphere of influence, the governance and organizational mechanisms adopted, the relationships between the players involved in investment transactions and the main performance measures adopted are analyzed.

The second chapter introduces and analyzes the different types of investments adopted by private equity operators and the various investment steps. The clusters examined include four types of investments, namely growth capital, buy-outs, turnaround, replacement, some of which will be studied in the final empirical analysis. As regards the steps that a Private Equity operator must go through to make an investment, there are three phases: Fundraising activity, which focuses on collecting the resources necessary to make the investments; Investing activity, which is the core process of the Private Equity business as it involves the decision making and deal making phases; Exiting activity, the phase in which the monetization of the value creation achieved during the investment period takes place.

The third chapter proposes a review of the past Italian and international literature, aimed at understanding whether the intervention of a private equity operator actually delivers a positive impact on the target companies and if this is not limited to the mere contribution of new financial resources but rather, to enable the company to enter a new phase of the life cycle, influenced and supported by the collaboration of a professional interlocutor. Finally, as a preparation for the final chapter, some past research is reported regarding the impact on the performance of these investments on the Italian SME market, which represents more than 90% of Italian companies.

The fourth and final chapter contains an empirical study that aims to examine, with reference to the Italian SME market, the effects of Private Equity investments on the main economic-financial

indicators (Revenues, EBITDA, Net Profit, Total Assets, Employment Rate) of the companies being invested. The achieved results are compared with some benchmarks, such as main macroeconomic indicators (national GDP and employment growth rate), the ISTAT database on Italian companies and the Mediobanca-Unioncamere research on Italian small and medium-sized industrial enterprises. At the end of the investigation, a study is carried out on the companies themselves, analyzing the financial statements before and after the investment date (with a three years' time horizon). The objective of this last analysis, not frequently found in past literature, is to examine the change in the annual growth rates of the previously mentioned dimensional and income indicators, in order to understand if there is a significant impact on performance due to the investment, or whether such growth was already present before the operation took place.

In the final conclusions, a summary view of the results obtained following the empirical research is proposed, comparing these outputs with past literature, with the aim of outlining the role that Private Equity assumes and its contribution to Italian medium-sized enterprises' market.

I. Chapter One: The Private Equity Industry

Definition and characteristics of Private Equity and Venture Capital

The private equity market is an important source of funds for start-up firms, private middle-market firms, firms in financial distress, and public firms seeking buy-out financing. Over the past years it has been the fastest growing market for corporate finance, by an order of magnitude over other markets such as the public equity and bond ones and the market for private placement debt.

Private equity is often confused with venture capital, as they both refer to firms that invest in companies and exit by selling their investments in equity financing. Considering the purely terminological front, the institutional investment activity in risk capital today takes on different connotations depending on whether one considers the most widespread practice in USA or in Europe, i.e., whether venture capital is considered distinct from private equity or as a sub-unit. In the United States, this form of intervention is divided into two autonomous categories, venture capital and private equity. The first includes all operations aimed at companies in the early stages of life or at a later stage of development, while the second concerns mature companies. The clear separation between the two investment categories not only reflects the life cycle of the company, but also includes distinctions relating to reputation, the process of selecting target companies, value creation and exit, characteristics that make them, according to many scholars, so different as to be irreconcilable.

In Europe, however, venture capital activity is regarded as a part of private equity. According to Invest Europe (European association representing private equity and venture capital funds), formerly EVCA, private equity is defined as an entity that makes long-term investments in small, medium, and large companies with the aim of making them larger, stronger, and more profitable, while venture capital can be described as a private equity investment that focuses on start-ups. In the wake of European practice, in Italy, AIFI has defined the private equity activity as "investment activity in the risk capital of unlisted companies, with the aim of enhancement of the investment company for the purpose of its disposal within the medium-long term".

Having defined the private equity activity, venture capital is part of it as a species within a genus. Venture capital does not therefore constitute a different activity distinct from private equity, but a particular private equity activity aimed at financing the company in the first phases of the life cycle, which are particularly delicate and “adventurous” (hence the definition of venture capital). In this regard, according to the moment in which the intervention of the operator occurs, the expressions seed, start-up and later stage financing are used. Considering these elements, in the continuation of the paper the characteristics of the private equity investment activity will be described and analyzed in detail, using the European terminological practice, and specifying, where possible, the different phases of intervention to which it refers.

Private Equity Funds: Organizational Structure and Performance Measures

Similar to a mutual fund or hedge fund, a private equity fund is a pooled investment vehicle where the adviser pools together the money invested in the fund by all the investors and uses that money to make investments on behalf of the fund. The substantial majority of private equity investments, at an international level, is made through funds, whose legal structure is that of a limited partnership. This mechanism is based on an agreement between the so-called limited partners (investors) and the general partner (the manager of the fund). The general partner (GP) is unlimitedly liable to third parties, including personal assets, for the obligations of the limited partnership. The limited partners (LP) have the benefit of limiting their liability to the share of subscribed capital.

The main role of the private equity firm is to provide investment advice to the private equity fund, created in joint partnership with the investors. The firm which acts as a general partner of the fund, also executes investment decisions, oversees the fund’s investments, and receives fees for these services. The professionals of private equity firms often have a wide variety of skills and experience and, generally, investors view the element of diversity in the creation of the investment team as a positive one. To raise funds successfully, investment teams have to present a convincing and deliverable investment strategy, appropriate investment credentials, and, fundamentally, evidence of prior success in executing a similar investment strategy.

Investors in private equity funds are the entities that provide capital to the fund. They provide the equity capital which is governed by strict legal rules (established in the limited partnership agreement) and task the GP with executing the prescribed investment strategy of the funds and delivering risk-adjusted returns. The LPs are effectively passive investors with no influence on the investment matters of the fund once it is established. By investing through a fund partnership rather than directly in the firms in which these funds buy stakes, the investors also gain access to highly skilled investment professionals with demonstrated abilities. Investors delegate to these professionals the responsibilities of selecting, structuring, managing and eventually liquidating the private equity investments. The private equity funds are established as a “blind pool” of capital. Consequently, once LPs commit their investment to the found, only the GPs have discretion on how to invest money and when to invest it or return it. Most private equity funds are “closed-end” funds, as investors cannot withdraw their investment until the fund is terminated.

Overview and Comparison of European and Italian private equity markets

In the last twenty years, private equity in Italy has undergone a significant expansion. Starting from the nineties, a very rapid growth has been observed, leading to the phenomenon of the "new economy", creating a first peak, between 2000 and 2001, in the number of active operators (86 in 2001). In fact, at the turn of those years, the birth of many subjects specialized in the early-stage compartment was registered. Between 2005 and 2010 the market saw a progressive growth of active operators (reaching 129) and also a growth of the average size of managed capital, while following the contraction suffered by the market after the international financial crisis and the difficulties encountered in the collection of new waves, a progressive consolidation was observed which saw the exit from the market of some operators and, more specifically, the aggregation of various initiatives. Today the number of AIFI members has returned to rise and, in 2020, stands at 150, including both domestic and international private equity, venture capital, and private debt operators active in Italy. The evolution in the number of private equity transactions has undergone a growth since the early 2000s, and then stopped and decreased during both the first financial crisis of 2008 and the sovereign debt crisis in 2012, which involved several European countries. However, after those years, the market has undergone a strong and unstoppable development which led, in year 2020, to 253 operations recorded in Italy. Moreover, in 2021, the private equity market is at record levels and provides proof of consolidated maturity in a very complex historical phase, registering 160 new investments just in the first semester of the year, while in the same period of 2020, which in any case had already concluded with absolutely positive evidence, 103 investments were mapped. To outline the current weight that the private equity industry has on the real economy, the following data emerges from the AIFI annual conference in 2021: the companies held in portfolio amount to 1.500 (considering both private equity and venture capital), for a total of 600.000 employees and about 200 billion euros of revenues. Regarding the European market, in 2020, investments in SMEs (with less than 250 employees) were about 85% in number of companies and 25% in amount invested. In 2019, those investments amounted to 84%, thus confirming a similar trend compared to Italian market (75% investments in SMEs).

II. Chapter Two: Private Equity Operations

Private Equity Investment Clusters

The objective of the paragraph is to illustrate the main characteristics of the various investment clusters, already mentioned in the previous chapter, that are involved in private equity transactions, in particular: growth capital, buy-outs, replacement financing and turnaround.

Growth Capital, also known as Expansion Capital or Growth Equity, is a type of private equity investment (often a minority investment) in relatively mature companies that are looking for primary capital to expand and improve operations or enter new markets to accelerate the growth of the business. In general, growth capital includes all risk capital invested in already existing and established companies used to incentivize development, dimensional growth, and potential quotation in a public financial market. This type of participation is less risky than those concerning the initial and start-up phase of a company because there is an already tested and well-functioning company with a significant base of customers.

Replacement financing, the typical support from private equity finance for firms in their mature age, funds companies looking for strategic decisions associated with the governance system and the firm's status, rather than the firm's approach to finance. Replacement financing is never used to boost sales growth or to realize investment in plants. Instead, it is used for strategic or acquisition processes. Replacement capital is the proper solution to fund spin-off projects, equity restructuring, shareholder substitution, IPOs, family buy-in or family buy-out, etc.

Buy-outs are defined as private equity interventions that are carried out in order to support the change in the ownership structure of the company involved in the transaction, and therefore where a real transfer of control occurs. Buy-out operations are therefore characterized by the fact that, within the investment, a change in the controlling structure occurs, which is normally acquired by the private equity operator (or by a group of operators), with all the consequences and responsibilities that this position entails. It is for this reason that these operations differ substantially from those of growth capital seen previously, which mainly referred to the purchase of minority stakes by private equity investors, and certainly also with respect to those of venture capital and early-stage financing. It is not a "partnership" with the entrepreneur, although this may in some cases happen.

Finally, we can define turnaround investing as the investment in a difficult economic and/or financial situation, with the prospect of relaunching it, in order to make a capital gain on the initial investment. This is true both for privately held companies and for listed companies: in both cases it is a question of identifying a firm that has an intrinsic value and a potential capable of achieving better results than the current ones, thanks to certain characteristic (such as market positioning, management, and brand).

Fundraising Activity

The fundraising activity is fundamental within the managerial process regardless the legal status of the deal, the organizational structure of subjects involved, and the characteristics of firms or projects selected later. The first step of the fundraising activity consists in the creation of the business idea. It starts by explaining the idea to the business community and catch the attention of potential investors. Business idea creation is aimed at producing an information memorandum to be promoted in the market. Before that, a preliminary phase, often called "taste of waters" occur. This is carried on in a very informal way among the professional network, with the aim to assess, for instance, whether it makes sense for the private equity investors to invest in a specific private equity cluster or not. We can identify the second step of fundraising activity with the name "Job Selling", in which it is crucial to identify the category of investors potentially interested in a fund. The fundraising strategy is profoundly influenced if the fund is new, or if it represents the continuation of a previous initiative; the absence of a track record and the necessity to develop a network of contacts makes the fundraising complex and laborious.

Investing Activity

Investing is the core of private equity business and the way to develop a business idea for the investor. There are two main initial steps in the investing activity:

- *Decision Making*: valuation and selection of opportunities and matching them with the appropriate investment vehicle. Target company valuation, the "core performance" of a private equity fund, is a proper blend of strategic analysis (about the business, the market, and the competitive advantage), business planning, financial forecasting, human resources, and entrepreneur and management team assessment.

- *Deal Making*: activity of negotiation of the contracts by which the private equity firm can invest and actively participate in the company. These contracts include, for instance, the calculation of the shares the investor has to buy and the corporate governance rules.

Once the two initial phases of the investment process are concluded and the investment agreement has been reached, a fundamental aspect of the investment phase concerns its monitoring and valorization. In order to increase the value of target companies, private equity exploits different strategies in order to get the highest value possible when exiting their investment. Strategies should be considered with the positioning of the fund declared in the fundraising phase.

Exiting Activity

Through divestment, the creation of value becomes from theoretical to effective, transforming the portfolio valuation into a price and consequently into a yield obtained on the market. For this reason, from the first analysis of the potential investment, private equity operators question themselves in advance about the exit possibilities and the most likely categories of potential acquirers at the time of divestment, despite being very distant in time. During the investment cycle, the prospect of exit cannot be neglected, in particular when the company must evaluate a transformational acquisition that could positively or negatively affect the success or the exit. Think of how profitable it is, for the purposes of a subsequent valorization, to have increased the scale of the company and its degree of internationalization through a build-up strategy and have placed it in a range of higher multiples. Among the several main strategies for divestment we find: the sale to a strategic buyer, the sale to a financial buyer, Buy-Back, IPOs, Write Offs.

III. Chapter Three: Private Equity and Value Creation – review of previous research

How can Private Equity help target companies?

The intervention of an institutional investor in the risk capital of a company is not limited to the contribution of new resources but may enable the company to enter into a new phase of its life cycle, influenced and supported by the collaboration with a professional interlocutor. The issue of the role of investors, who are not only "capital providers", but real active owners who, working in support of the board and management of the company, contribute to the implementation of growth and value creation strategies, emerges centrally. As proof of the validity of this type of attitude, several studies have shown how investor activism can contribute to achieve higher performance than the market or the reference benchmark.

The areas which, according to the market practice and sector literature, are typically subject of intervention by private capital operators will be dealt with in detail below:

- Contribution of professional contacts and sounding board effect for the entrepreneurial idea.
- Support for the review of managerial processes and strategic framework.
- Support for internationalization, external growth, and creation of new business areas.
- Financial advice and services.
- Focus and investment in innovation, research, and development for greater production competitiveness.
- Support to the entrepreneur in dealing with managerial processes and possible generational transitions.
- Promotion of ESG practices.

Main results from previous international research

Over the last few years, numerous research have been carried out having as objective the analysis of the contribution of private equity and venture capital operations to economic growth. Most of these studies are summarized in a document produced in 2013 by Frontier Economics for EVCA (European Venture Capital Association), which focuses on the impact of operations in terms of innovation, productivity, and internationalization.

First of all, private equity is able to increase innovation, not just by providing capital for research and development, but also, for example, helping the company to focus on its own strengths. Typically, this impact is measured by the number of patents. The relationship between patents and economic growth is not clear cut, and patent regimes are not a primary determinant of growth. In addition to support for innovation, further research show how private equity contributes to making portfolio companies more productive, supporting aggregate economic growth. Among the interventions that can be implemented by private equity investors we find, for example, strategic and managerial improvements, economies of scale, employee incentives, which lead to time saving and to a greater ability to exploit business opportunities. The third field of analysis on the economic impact of private equity is related to the benefits in terms of competitiveness and internationalization: in particular, numerous studies demonstrate the contribution to the processes of internationalization, often very difficult for smaller or younger companies.

After combining a review of the studies carried out in recent years at an international level, we can observe that most of them have found a decidedly positive impact of private equity on target companies, supporting them by increasing the level of innovation, productivity, internationalization, and competitiveness. However, in some cases there is also evidence of a non-positive impact on the performance of the companies in the period immediately following the investment.

Specific research about the contribution of Private Equity to Italian SMEs

The Italian market mainly relies on small and medium-sized enterprises (SMEs). To better understand the weight of SMEs within the Italian economic and production framework, it is good to linger on the numbers. Out of 4,4 million active enterprises in Italy, micro-enterprises with fewer than 10 employees are numerically the most important ones, representing 95,05% of the total, against 0,09% of large enterprises. On the other hand, Italian SMEs are about 206 thousand, i.e., the remaining 4,86% of the Italian entrepreneurial market, and are responsible, alone, for 41% of the entire turnover generated in Italy, for 33% of the total number of employees in the private sector and 38% of the country's added value. SMEs have all the credentials to be able to give impetus to the Italian economic (and territorial) development, also thanks to the increasing support provided by private equity investors. Making a comparison with the Italian scenario, based on the parameters analyzed in the previous paragraph, we note how the impact of private equity on Italian companies is mostly positive.

A recent study called "The economic impact of Private Equity and Venture Capital in Italy", carried out by PwC (PricewaterhouseCoopers) in March 2018, shows that companies owned by private equity or venture capital funds have performed better than other Italian companies in terms of revenues from sales and services, EBITDA, and employment. This research took into account a sample of 499 disinvestments, of which 218 of venture capital (also including growth capital) and 281 of buy-out, carried out in Italy from 2008 to 2018. The analysis revealed that the companies owned by private equity and venture capital funds were characterized by an annual growth in revenues of 5,5%, about four times more than the Italian companies taken as benchmarks (1,3%). This growth rate was significantly higher than the growth of the Italian gross domestic product, which stood at around 0,7%. As regards the employment rate, unlike the positive but stationary 0,0% recorded in the reference sample, the companies in which private equity operators have an interest recorded an annual increase of 5,1%.

A study conducted by the LIUC University in January 2014 called "The economic impact of private equity in made in Italy", examines the private equity transactions carried out in Italy from 2007 to 2012 (excluding investments made by public operators, those addressed to start-ups and secondary buy-outs). Analyzing the data of the companies active in the Made in Italy sectors, from the research it emerged that between 2008 and 2010 the companies in which private equity holdings registered a growth in turnover equal to 4,3%, while the ISTAT data relating to the same period and the same sectors show a decrease of 5,1%. Even compared to GDP, which recorded a decrease of 1,9% between 2008 and 2010, the performance of companies held by private equity funds are certainly very positive. Similar results characterize the level of employment: the study, in fact, shows a positive trend with a CAGR of +4,1% for the companies subject to investment, which exceeded the reference benchmark, characterized by -4,0%.

It is also worth mentioning, although not so recent, a similar investigation conducted in 2008 by Francesco Bollazzi, professor at LIUC University. The study aims to analyze the economic impact generated by institutional venture capital investors in development finance operations (growth capital) targeting a family business, in the interval between the year of entry and the year of exit of the shareholding structure. According to the study, the presence of negative changes was recorded for 39% of the companies belonging to the sample, while the remaining 61% maintained a positive trend during the investment period. Among others, 18% of the sample shows an average annual growth even higher than 90%.

IV. Chapter Four: Empirical Analysis – the impact of Private Equity on the performance of target SMEs

Methodology

The empirical analysis aims at understanding if and how the institutional investor has generated value and identify its real contribution to the development path of the investee company. It is conducted on private equity transactions carried out in Italy from 2013 to 2016. The transactions are identified in the annual reports published by the Private Equity Monitor (PEM), which takes into consideration only "the new investments made by institutional investors in private capital risk, in all phases subsequent to those of business start-up, thus excluding investments made by public or para-public operators, venture capital operations and reinvestments in companies owned by the same operator, the so-called follow-on". With reference to each company in the sample, a series of information and indicators were acquired which made it possible to carry out an analysis on two levels: qualitative, framing the phenomenon in question at a temporal, geographical and sectorial level; quantitative, through budget, financial, performance and employment indicators. More specifically, to study the economic impact of private equity on target SMEs, income indicators (EBITDA and Net Profit) and dimensional indicators (Revenues, Employees and Total Assets) will be examined. The data of the companies were obtained through the AIDA - Bureau Van Dijk database, containing the financial statements, personal and product data of all active and bankrupt Italian joint stock companies (excluding Banks, Insurance Companies and Public Entities). The results of the study will then be expressed in terms of CAGR (Compound Annual Growth Rate), which measures the annual growth of a particular indicator over a specific period of time. First of all, the analysis will focus on to comparison with some reference benchmarks, to understand if and to what extent the results provided by the sample differ from the results recorded for companies that are not owned by private equity funds. In particular, the benchmarks taken into consideration are three: Macroeconomic indicators (such as national GDP and Employment Rate), Mediobanca-Unioncamere research, which presents the annual results of Italian industrial SMEs between 2008 and 2018, and data provided by ISTAT (National Statistical Institute) which provides the economic annual results of Italian companies. Subsequently, the data collected will be used to carry out several analyses on the sample, including a comparison of targets' performance in the three years before and after the investment, in order to have a complete picture of the type and extent of the impact provided by private equity operators. In this way it will also be possible to understand if this impact is significant or if similar growth rates were recorded even before the investment, therefore attributing to the operator the ability to select specific companies that record higher returns and growth rates than others, in order not to modify the previous trends of acquired companies and helping to maintain or even accelerate the performance of already growing companies.

Sample Definition

First of all, as already mentioned, it was decided to consider, through the PEM database, all the investments (not necessarily already divested) made between 2013 and 2016, in order to be able to collect all the necessary financial statements available on the AIDA database before and after the investment date. The former sample is composed by 360 companies (69% buy-out, 25% growth capital, 4% turnaround and 2% replacement). For obvious statistical reasons, the analysis will mainly focus on buy-outs and growth capital transactions, thus not considering the other typologies. Furthermore, for some of the transactions covered by the experiment, it was not possible to retrieve the data on the financial statements from the AIDA database because of their absence or incompleteness. After necessarily excluding also large companies and secondary buy outs, the total number of companies in the sample amounts to 107.

From a sectorial point of view, 33,6% of the small and medium-sized enterprises in the sample operate in the industrial products sector. Following this, with a percentage equal to 21,5% of the total, are the companies belonging to the consumer goods sector, while the third most invested sector is that relating to food and beverage with a percentage of 15,9%.

Another important and deserving aspect of further study is the one relating to the amount of share capital through which the investor enters the shareholding structure of the target company. In particular, 7,5% of the sample acquired shares not exceeding 25%, 21,5% shares between 26% and 50%, 31,8% shares between 51% and 75%, lastly 39,3% shares ranging between 76% and 100%. Consistently with the types of transactions taken into consideration, i.e., buy-outs and growth capital, most operations are characterized by the acquisition of a majority stake by the private equity investor.

Sample Analysis and Benchmark

The first analysis carried out on the sample concerns the involvement of two macroeconomic indicators, namely the Italian GDP and employment rate. To make a comparison between the trends of small and medium-sized enterprises invested by private equity operators, it was decided to take into consideration the average CAGR in the 2016-2019 four-years' time horizon (i.e., exactly the following three years compared to the investment date). Over the period, private equity-owned companies have continuously grown at a higher pace compared to the Italian market, both in terms of revenues and employment growth rate. In the following chart the comparison between GDP's CAGR and PE backed companies' revenues and EBITDA is displayed. The second macroeconomic indicator used as a benchmark for the sample refers to the employment rate. The employment growth rate trend in Italy has shown a quite flat trend over the reference period, however highlighting a slight decrease ending in 2019 (about -0,4%). Over the same period, Private Equity backed SMEs have always kept a higher employment growth rate, constantly about 7% above the national rate.

The second benchmark to be analyzed is constituted by ISTAT data on the annual economic results of all Italian companies, hence including the ones not participated by a private equity fund. Considering only small and medium-sized enterprises, up to a maximum of 250 employees, the ISTAT data show an annual negative turnover growth rate in the three-years' time horizon, with a value of approximately -1%, while the companies owned by private equity shows, in the three years following the investment, a positive turnover growth rate, much higher than the reference benchmark, for a total difference of 9,87 percentage points. In terms of EBITDA, the average CAGR of the sample amounts to 11,8%, while the reference benchmark, pointed out by ISTAT in a three-years' time horizon is about 2,8%. Also, in this case the PE backed firms have a much higher growth rate than the national average for small and medium-sized enterprises, with a difference of about 9 percentage points. The last comparison worth exploring using the data provided by ISTAT is that of the growth in the employment rate. In this case, companies invested by private equity operators, which have an average employment rate's CAGR of 9,1%, exceed the benchmark provided by ISTAT by almost 8 percentage points.

After comparing the data contained in the sample with those provided by the ISTAT databases, it was deemed necessary, in order to confirm these trends, to compare the sample also with further research. For this reason, the research carried out by Mediobanca and Unioncamere will be used, which analyzes Italian small and medium-sized industrial enterprises, for the period that goes from 2009 to 2018 (the period taken into account will be a three years' time horizon, similarly to the sample). Differently from the data found by ISTAT, which however also includes small and micro enterprises, the average annual growth of revenues measured by the benchmark is positive, but in any case, much lower than the CAGR recorded in the private equity backed companies analyzed. The difference, however, remains almost similar to that found by comparisons with other benchmarks. If we take into consideration the data on the growth of the employment rate we see that the CAGR detected by the benchmark is significantly lower (0,23%) for the analyzed years, the sample instead returns an employee growth rate of 9,1%, also in this case the data collected by ISTAT and Mediobanca-Unioncamere are very close to each other, and the difference with the sample is almost the same and is around 9-10 percentage points. Finally, the last indicator to be analyzed is that of total assets growth rate. In this case, the growth of total assets in companies owned by private equity operators (in the three years following the investment) is on average much higher (14,99%) than the growth of total assets recorded in Italian medium-sized industrial companies (1,05%), with a difference of approximately 14 percentage points.

After carrying out an analysis by comparing the average data collected in the sample with those observed in the reference benchmarks, it was deemed appropriate to investigate the impact of private equity on the target companies themselves, comparing the performance trends before and after the investment (taking into consideration the three previous and three subsequent years). The main objective of this last step is to actually ascertain whether, as stated by some research in the literature, private equity has a significant and clearly visible impact compared to the pre-investment period, or whether private equity companies only select firms that already have high growth rates, helping only to accelerate or maintain the performance of companies that are already growing. Overall we can observe that there is no significant difference between the pre- and post-investment averages. The only exception is constituted by the average employment three-years CAGR, which, being subjected to the T-Test, reported a significant difference for $p < 0.05$. In conclusion, we can say that, on average, the compound annual growth of target firms after the investment is slightly higher than in the previous period. However, these differences are not overwhelming, except for the rate of employment growth which is significantly higher in the subsequent period.

Discussion of results

From the empirical research proposed in chapter four, several conclusions can be drawn. First of all, it is important to underline how by comparing the data on Italian SMEs subject to private equity investment with the benchmarks illustrated in the introduction phase, the skills and resources provided to the target companies favor a much higher growth of the invested company compared to the average recorded by the macroeconomic indicators, ISTAT and Mediobanca-Unioncamere databases. In fact, as supported by provided data, companies that are subject to private equity investments have significantly higher CAGR in size and performance than non-investee companies. As we noted in the final part of the analysis, taking into consideration the total averages, we observe an improvement in growth rates in the period following the investment for all indicators except for the Total Assets' CAGR, for which post-investment growth is slightly lower than pre-investment growth. However, the gap recorded in the two periods is not particularly significant, in fact the biggest differences are recorded in the employment growth rate, around 3%, and in the EBITDA growth rate, around 4%. This suggests that private equity firms, on average, excluding turnaround operations, usually target small and medium-sized enterprises that already have rather high growth rates, or at least fairly above average. The only exception in which the difference between the growth rates is statistically significant is that concerning the employment rate, which is significantly higher in the period following the investment by a private equity fund.

Conclusions

At the end of the proposed research, it is possible to affirm that, in general, the entry of a private equity fund into the share capital of a target enterprise positively influences the economic and financial performance of the investee company. This emerged both when the theoretical part was treated, and also when the empirical analysis was performed in the fourth chapter. In fact, for the company, the entry of a fund represents not only a contribution of capital but also a contribution of skills, of know-how transfer, of help in management, of exploitation of the network of contacts that the fund has. The relationship that is formed between investor and company is undoubtedly to be considered win-win, since the fund actively strives to ensure that the investee company increases its value. The more this value increases, the more the capital invested by the fund will be remunerated.

Observing the studies carried out in the document produced by Frontier Economics in 2013, we can see how, at an international level, most of the research attributes to private equity firms a decidedly positive impact on target companies, supporting them by increasing the level of innovation, of productivity, internationalization, and expertise. Also in Italy, from the research analyzed, it is believed that private equity represents, for Italian companies, an option to be taken into consideration;

also, in the light of an entrepreneurial system characterized for the most part by small and medium-sized enterprises, undercapitalized, family-owned, poorly managed and grappling with the challenges deriving from globalization.

As regards the first objective set by the empirical analysis, the results obtained are definitely positive and confirm what has been observed in the literature. The analysis was carried out on a sample of 107 small and medium-sized Italian companies invested between 2013 and 2016. By examining the annual growth rates in the three years following the investment, we note that the vast majority of companies in the sample present a clearly positive CAGR for all the indicators analyzed (Revenues, EBITDA, Net Profit, Total Assets, Employment rate). On the other hand, with the exception of Net Profit, the number of companies whose indicators show a negative CAGR in the three years following the investment are negligible. After having outlined and analyzed the sample in detail, the data were compared with three benchmarks, in order to seek a comparison with a sample of companies not involved in private equity investments. The adopted benchmarks were: two main macroeconomic indicators, hence Italian GDP and Employment growth rates; the ISTAT database, which collects data on all Italian companies broken down by number of employees between 2015 and 2018; the Mediobanca-Unioncamere database, which collects data on all Italian small and medium-sized industrial enterprises between 2008 and 2019. The analysis showed that the growth rates of small and medium-sized enterprises subject to investments are much higher than those provided by the reference benchmarks containing non-investee companies.

At first sight, therefore, it would seem that the collaboration between the private equity investor and the small-medium enterprise has had an extremely positive impact in the growth process of the target. For this reason, in the second part of the analysis, it was decided to compare the data from the three financial statements before and after the investment of the companies observed in the sample. The results of this analysis show how, following the investment, the growth rates of the analyzed indicators are on average higher than those recorded in the pre-investment period. However, the differences between the periods before and after the entry into the share capital by the private equity operator are not overwhelming, on the contrary, the percentages, on average, are very close to each other, with the only exception of employment growth rate which results significantly higher in the period subsequent to the investment. Therefore, the conclusion deriving from this analysis, while confirming the positive role of private equity as a support for the creation of value for the company, which goes beyond the mere contribution of financial resources, also confirms the widespread opinion according to which private equity does not significantly change the previous trends of acquired companies, but rather helps to maintain or even accelerate the performance of companies that already have high and constant growth rates.