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Capital Markets and Investors in Italian Securities: Is There a Communication Breakdown?*

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In collaboration with



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Preface

by EQUITA SIM

Capital markets are an increasingly important source of funding for Italian companies. Following the onset of the financial crisis in 2008 and the subsequent credit crunch, corporates worldwide have realised that it is essential to develop alternative sources of funding and to avoid relying excessively on bank financing. This development is extremely positive, particularly within the Italian economic environment which has historically resorted almost exclusively to conventional bank credit, displaying financial weakness during the crisis.

However, the transition by Italian companies to a more balanced funding structure is still far from complete. As the Governor of the Bank of Italy, Mr. Ignazio Visco, made clear in May 2014, Italian firms' indebtedness and dependence on bank credit are signs of their financial vulnerability. With almost €1.3 trillion in financial debt and €1.6 trillion in net equity, Italian firms' overall leverage is 44 per cent; bank loans account for 64 per cent of the total debt. For the euro area these ratios are considerably lower, averaging 39 and 46 per cent respectively (...) Bringing financial leverage into line with the European average would require a capital increase of around €200 billion and an equal reduction in debt.”¹

It is therefore quite clear that fostering the development of capital markets is an important priority for our country. In light of this, we welcome the opportunity to continue Equita's three-year cooperation with Università Bocconi aimed at analysing the key features of the capital markets for Italian companies and proposing concrete initiatives to improve them. The hope is to gradually make these markets comparable by quality and size to the most developed ones in Europe.

We are also pleased that the Italian government and national regulators have made further progress in simplifying access to the capital markets for Italian companies. This has been achieved through further improvements to the regulations regarding both bonds issuance by unlisted companies (so-called “minibonds”) and lending by non-bank entities. A set of initiatives has also been implemented which streamline the obligations for small and mid-size listed companies and offer more favourable tax treatment for the issuers. In this respect, Italian companies in all honesty have no excuses preventing them from looking for alternative funding sources and accessing the capital markets.

It is therefore even more disconcerting to consider the treatment of equity and debt investors, particular domestic investors, who alone systematically invest in small and mid-caps and constitute the key pillar needed to support deep and successful capital markets. These are the very investors who are largely ignored and most poorly treated by our governments, institutions and media, despite the fact that most senior representatives of our key institutions keep reiterating that investors should increase their exposure and commitment to the “real economy”.

The current tax regime, as a matter of fact, totally discourages anyone from investing in publicly traded shares or bonds of Italian companies, i.e. the “real economy”:

- *Italy is the only country other than France to have adopted the Tobin Tax, which has proven to be useless in terms of tax revenues and damaging to the Italian stock markets in comparison with other European exchanges. The Italian Tobin Tax has also been structured in a highly controversial way: anyone buying and selling equities in the same day will pay no Tobin Tax, which clearly encourages short term speculation and discourages long term investment in Italian companies!*

¹ The Governor's Concluding Remarks - Ordinary Meeting of Shareholders - Rome, 30 May 2014

- Moreover, investments in Italian companies are taxed at much higher rates than those in government debt. Even real estate investments by individuals incur no capital gains taxes after 5 years. But people who invest in debt or equity securities for two days or for 10 years will still pay exactly the same hefty 26% capital gains tax.

This is a major distortion in the investment policies of individuals. What's more, this policy is particularly misguided as it encourages high-saving Italians to invest only in government debt and real estate. This strategy is not useful for the economy, nor does it help people build an asset allocation consistent with their future needs as retirees, unlike in most developed Western countries.

Moreover, no money has been committed by the Cassa Depositi e Prestiti or other public institutions to a fund of funds dedicated to listed small-caps, despite reiterated calls from the financial industry. The money theoretically earmarked to fund the minibonds has not yet been allocated, and this more than two years after the change in regulations that allowed Italian companies to issue these instruments.

Finally, Italian banking foundations, pension funds and similar entities continue to dedicate a minimal part of their total assets to Italian companies. Instead in other countries such as Japan, the main pension funds have decided to increase dramatically the portion of assets invested in domestic equity and debt securities, i.e. the productive economy.

The result of all of this is the lack of a strong domestic investor base that can sustain our economy, absorb financial shocks coming from abroad and protect the future wellbeing of prospective retirees. In light of all this, it is truly troubling to read in Milano Finanza that in 2014 an estimated €200 billion have been subtracted from the Italian real economy due to a number of factors, including over €100 billion of Italian savings invested in foreign assets.²

We find it perplexing, to say the least, that equity and debt investors are not one of the key priorities of our public institutions. We believe our policy makers should be fully aware that since 2008, equity investors have effectively saved the Italian financial system through an aggregate investment in the capital increases of companies and banks totaling almost €70 billion, i.e. equivalent to the average commitment by the main European governments to bail out their banks. This same amount, €70 billion, is also similar to the aggregate value of all the budget laws passed in Italy since Mr Monti's in 2011. This means that investors have contributed enough money to the system to prevent further painful tax increases and spending cuts, which would have been unbearable for the Italian economy. But after many years of poor financial returns, as substantiated by the worst stock market performance of any European market with the sole exception of Greece, investors in Italian securities are increasingly rare. As a result, we need a coordinated policy and specific incentives to increase their exposure to our economy. To prove the point, suffice to note that 50% of the Initial Public Offerings on the main Italian stock market since 2008 have failed to be completed, twice as many as in the main European markets. This prevents high-quality companies such as Intercos, Fedrigoni and Rottapharm from achieving their objectives and spurs some of them to find foreign buyers to replace the Italian stock market.

² Milano Finanza, 3 January 2015

The key initiatives which are needed to address these issues are very simple and clear to anyone working in the financial industry:

- *Provide incentives, including tax breaks, to encourage Italians to invest in debt and equity securities, with bigger incentives for people who are willing to invest for a longer period of time (similar to Individual Savings Accounts in the UK).*
- *Dedicate specific funds, partly backed by public entities, to investments in Italian small caps (similar to Venture Capital Trusts in the UK).*
- *Aggressively encourage banking foundations, pension funds and similar entities to increase their exposure to the productive economy in Italy by actively investing in Italian securities other than government debt.*
- *Repeal the Tobin Tax.*

More generally speaking, there is a need to foster a culture where investing in securities is not represented as “speculating”, and where investments are not defined as “financial annuities”. The Italian translation of this latter term (“rendite finanziarie”) has a clear negative nuance, as if it were compared and contrasted to productive investments. Financial investments are the key to the growth of our economy, and investors are the essential ingredient for our economic development.

We sincerely hope that our policy makers and regulators will focus on this vital issue and develop a coordinated legal and fiscal framework. Once again, we thank Università Bocconi for this important project and for the high quality analysis of the Italian investor base and its shortcomings, as addressed in this paper.

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Stefano Gatti is Director of the Full Time MBA at SDA Bocconi School of Management. His main area of research is corporate finance and investment banking. He has published in these areas, including recent articles in the Journal of Money, Credit and Banking, Financial Management, the Journal of Applied Corporate Finance and the European Journal of Operational Research. Professor Gatti has also published a number of books on banking and finance areas and has acted as a consultant to several financial and non-financial institutions and to the Italian Ministry of the Economy, the Financial Stability Board and the OECD/Group of G20. He is financial advisor of the Pension Fund of Healthcare Professions and serves on the Boards of Directors and Boards of Auditors of Italian industrial and financial corporations.

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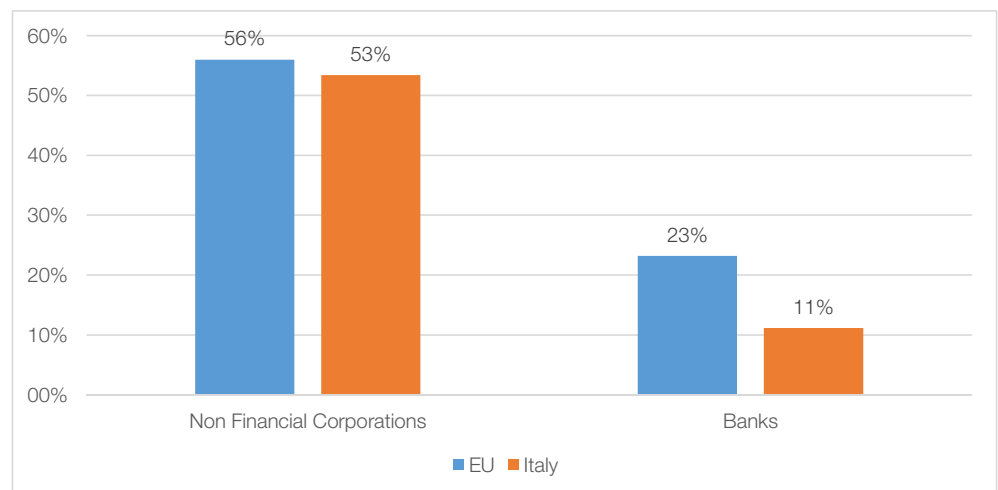
- Introduction
- Recent trends in company financing and the role of financial investors in a changing landscape
- A demand-side empirical analysis of investors' appetite for Italian companies' debt and equity securities
- Conclusions and Recommendations
- **Appendix:** An overview of the fiscal and normative framework for investors and its most recent developments

Introduction

It is a broadly shared opinion that one of the key factors contributing to the fragility of the Italian economy is the undercapitalization of its companies and of its banks with respect to their European counterparts. In particular, higher leverage, which is typical of both Italian companies and banks, represents a crucial weakness of the system, one which amplifies the impact of adverse macroeconomic shocks, first on banks' balance sheets and ultimately on credit supply. All this triggers a vicious cycle between the financial sector and the real economy. In the end, because of its undercapitalization, not only is the Italian economy more vulnerable to adverse macroeconomic shocks than the other European economies, but it also suffers more severe consequences.

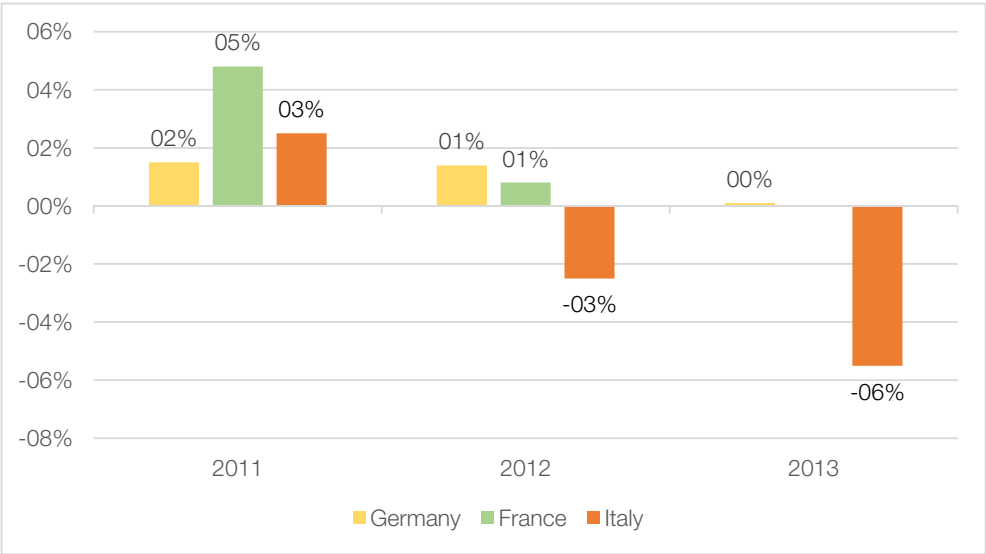
In line with the view that the Italian economy is more vulnerable because of the financial structure of its corporations, *Figure 1* compares the aggregate capitalization of Italian banks and non-financial corporations, measured by the ratio of their equity over the sum of their equity and debt, with respect to the levels observed across the European Union. What emerges is that both Italian banks and non-financial corporations are undercapitalized with respect to their European peers. It is not surprising, then, that the Italian banking system proves to be the most fragile in Europe, based on Asset Quality Reviews, with nine banks failing the stress tests. Italian banks are also less capitalized than European banks in terms of the Common Equity Tier 1 Ratio. Indeed, according to the most recent report by the ECB on the aggregate results from its Comprehensive Assessment Exercise, using end of 2013 data, the Common Equity Tier 1 Ratio of Italian banks is on average 10.2%, which is below the corresponding ratios of both French (11.5%) and German (13.2%) banks, and lower than the aggregate figure across all European Union member States (16.1%).

FIGURE 1
Capitalization:
Italy vs. Europe
(averages 2011-2013)

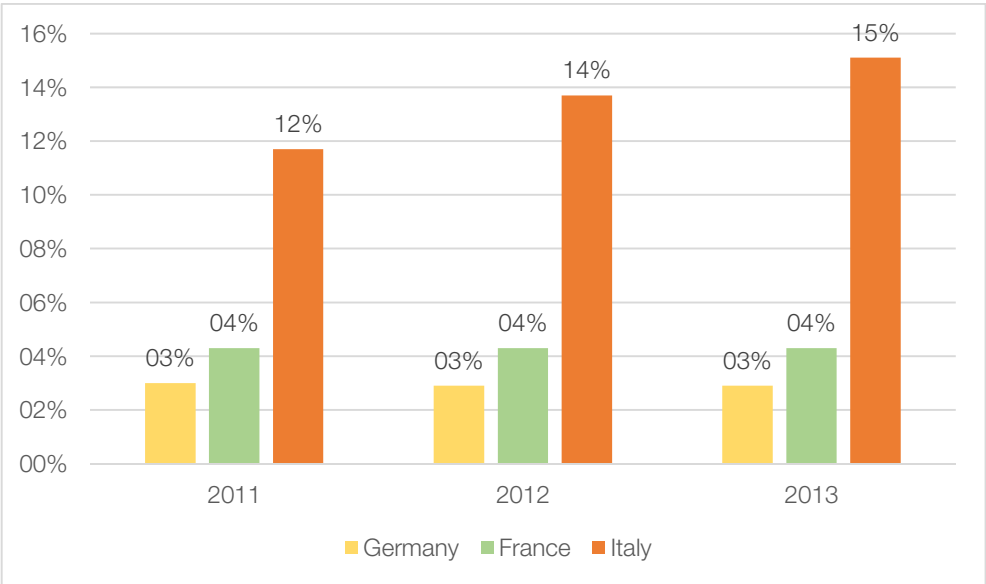


Source: Eurostat, IMF

As a consequence, standing on relatively less robust legs, the Italian economy and in particular its banking system are more severely affected by adverse economic shocks than other countries. In this respect, *Figures 2 and 3* respectively illustrate the most recent developments in bank lending to non-financial institutions and the proportion of the outstanding loans that are classified as non-performing, across major European economies. Not surprisingly, aggregate data show that amid the recent economic slowdown, the Italian economy has suffered from both a sharper contraction in bank lending and a steeper growth in non-performing loans than other major European economies.



Source: ECB



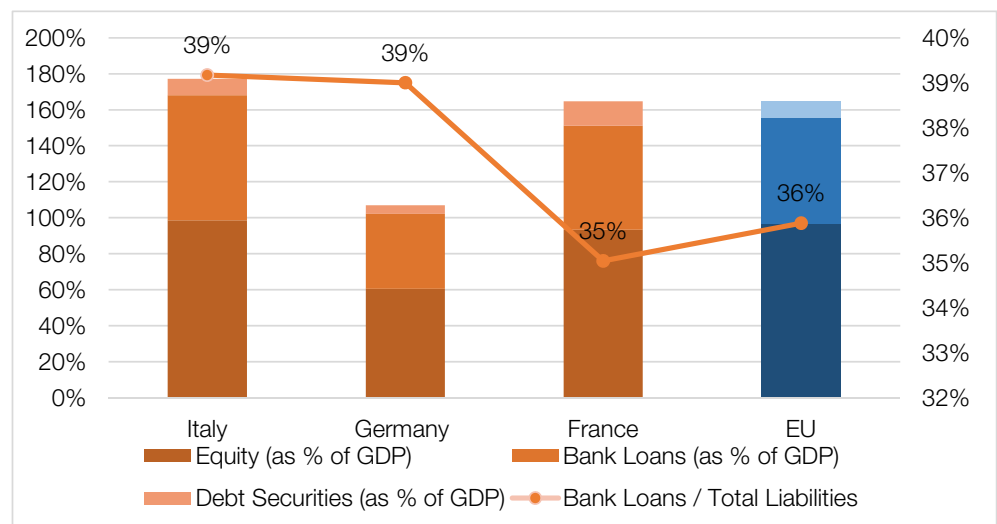
Source: World Bank

FIGURE 2
Bank credit supply:
Annual growth in bank
loans to non-financial
firms: Italy vs. major
European economies

FIGURE 3
Bank credit supply:
Annual growth in bank
loans to non-financial
firms: Italy vs. major
European economies

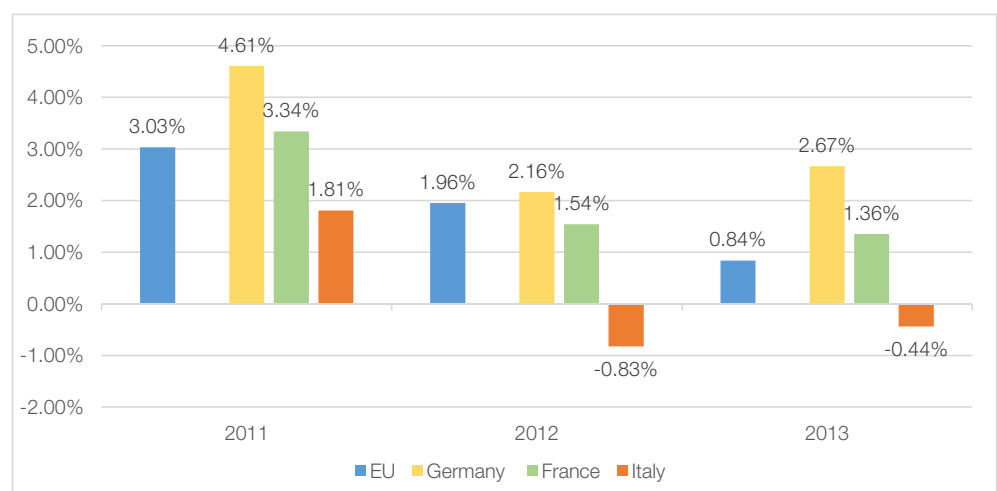
The intrinsic vulnerability of the system due to its undercapitalization is further worsened by the excessive dependence of Italian companies on bank lending and their as of yet underdeveloped recourse to alternative sources of debt capital. *Figure 4* clearly demonstrates that reliance on bank loan financing in Italy is greater than in other major European economies. This lack of flexibility in terms of sources of financing and the bank-centrism of the system lead to a direct consequence: the investment and production capacities of Italian companies are tightly linked to the health of the banking sector and vice-versa. The entire system therefore is more fragile to an adverse shock to credit supply or firm profitability, with more severe economic consequences as the aftereffects reverberate from the banking sector to the real economy and back again. In support of this line of reasoning, *Figure 5* clearly illustrates how the Italian economy has underperformed in the last few years with respect to other major European economies in terms of GDP growth.

FIGURE 4
Financing of non-financial firms: Italy vs. Europe and major European economies



Source: Eurostat, IMF

FIGURE 5
GDP growth: Italy vs. Europe and major European economies



Source: Eurostat

In light of all this, the process of strengthening the Italian economy necessarily passes through the development of capital markets. On the equity side, companies and banks need capital to rebalance their capital structure by increasing their capitalization. On the debt side, instead, companies need to expand the range of their sources of debt to overcome the squeeze on bank lending.

Unfortunately the current development of capital markets in Italy, notwithstanding the recent fiscal and normative efforts,³ sharply contrasts with the central role these markets should take. In fact, both debt and equity capital markets have their own severe limits.

On the debt side, the inadequacy of the domestic capital market has favored the development of foreign markets which are dominated by large foreign investors. As a consequence, access to these markets is restricted only to Italian companies with sufficient critical mass or enough international recognition to attract investor interest. This means that the majority of medium- and small-sized companies, which are the backbone of the Italian economy, are left out of this form of financing. In support of this argument, Table 1 shows the breakdown of the €29 billion volume of issuance by European companies on major private placement markets in 2013. The dismal contribution of Italian companies is restricted to the well-developed U.S. market, where the average size of an issue is approximately \$136 million. No Italian company has accessed either the more mature German Schuldschein market or the nascent UK and French Euro markets, where the size of an issue typically ranges between approximately €50 million and €100 million.

Market	European € bn	Italian %
U.S. Private Placement	€13 bn.	3%
German Schuldschein	€8 bn.	n.a.
French Euro Private Placement	€4 bn.	n.a.
U.K. Private Placement	€4 bn.	n.a.
Total	€29 bn.	

Source: S&P⁴

On the equity side, in the last five years 65 companies have raised €7.3 billion. and €40 billion. in initial and seasoned public offerings respectively. Nonetheless, the Italian stock market is underdeveloped as compared to the major European ones both with regard to size and performance. In absolute terms, just over 200 non-financial companies are currently listed on the Borsa Italiana, while Germany and France each count more than 700 listings. Moreover, according to data collected by the World Bank, the capitalization of Italian listed companies corresponds to just 23.8% of the GDP, while the average for the Eurozone is approximately 57% of the GDP and ranges from 43.4% in Germany to 69.8% in France. On top of that, more than 40% of total market capitalization is held by foreign investors, who also account for 90% of institutional assets. Since the beginning of the financial crisis, in early 2007, the Italian stock market has been the second worst performer among major European equity markets, recording losses equal to -53.8% against the -25.5% European average. In addition, the Italian stock market is apparently less appealing for not-yet-listed firms. The median Italian firm listed on the Borsa

TABLE 1
The breakdown
of the volume of issuance
by European companies
on major private placement
markets, 2013

³ An overview of the fiscal and normative framework for equity and debt investors and its most recent developments can be found in the Appendix of the paper.

⁴ Standard & Poors (2014), Mid-Market Funding in Europe Is Making Strides, But Has Far To Go, RatingsDirect, April

Italiana capitalizes approximately €90 million. -significantly more than the median firm listed in Germany or France. The market has also registered relatively fewer IPOs, more frequent withdrawals and increasing de-listings in the last few years. In particular, since 2008, the rate of withdrawn IPOs (over all announced IPOs) has reached 57%, well above the average rate computed across other major European equity markets, which does not exceed 25%.

TABLE 2
The volume of IPOs
and the frequency
of withdrawals for major
European stock exchanges,
2008-2014

Stock Exchange	Completed		Withdrawn	
	#IPOs	Amount (€ mil.)	#IPOs	over all % announced IPOs
Boerse Frankfurt	66	12.901	25	27%
Bolsa de Madrid	13	9.639	11	46%
Borsa Italiana	13	6.870	17	57%
Euronext Paris	68	8.865	7	9%
London Stock Exchange	137	58.003	52	28%
Swiss Exchange	11	2.712	2	15%
Total	308		114	

Source: Dealogic

Also looking in more detail at the recent developments on the AIM market, the impression is that there is a disconnection between companies' financing needs and capital markets. While the number of new issues has hit a new record high in 2014 with 19 IPOs, the size of the offer had to be reduced from the initial target in 11 cases out of 19 due to a lack of interest from investors. The average reduction in the issue size was approximately -45% of the original target and for all issues secondary trading has been rarified so far, with very limited daily volumes and many days with no trades at all.

Given the importance of bringing together companies and capital markets, it is essential to disentangle the reasons for the poor development of Italian capital markets and their disconnection from companies. Is this driven by a lack of interest among investors in equity and debt securities issued by Italian companies? Or by the inability of companies to reach these pools of capital?

Therefore, the aim of this paper is to study the attitude of investors towards equity and debt securities issued by Italian companies. In particular, we will analyze the investor universe in terms of the development, structure and size of these instruments in an effort to assess the potential demand for this investment asset class. Ultimately we seek to understand their potential role in financing Italian companies. Our intuition is that there is ample room for expansion in investments in equity and debt securities issued by Italian companies, with regard to institutional and retail capital as well as domestic and foreign investors. Until now, companies have suffered from limited access to retail capital due to regulatory limitations on the investors' side, from the absence of a strong private pension pillar and from the lack of a wide base of domestic institutional investors. As many of the existing restrictions are gradually easing, investments can expand and a larger pool of capital will become available to companies. Other trends are also underway which foster access to capital markets for a broader set of companies, such as the hunt for risk by return-starved investors as well as the ongoing disintermediation process by which new lenders are increasingly substituting bank credit.

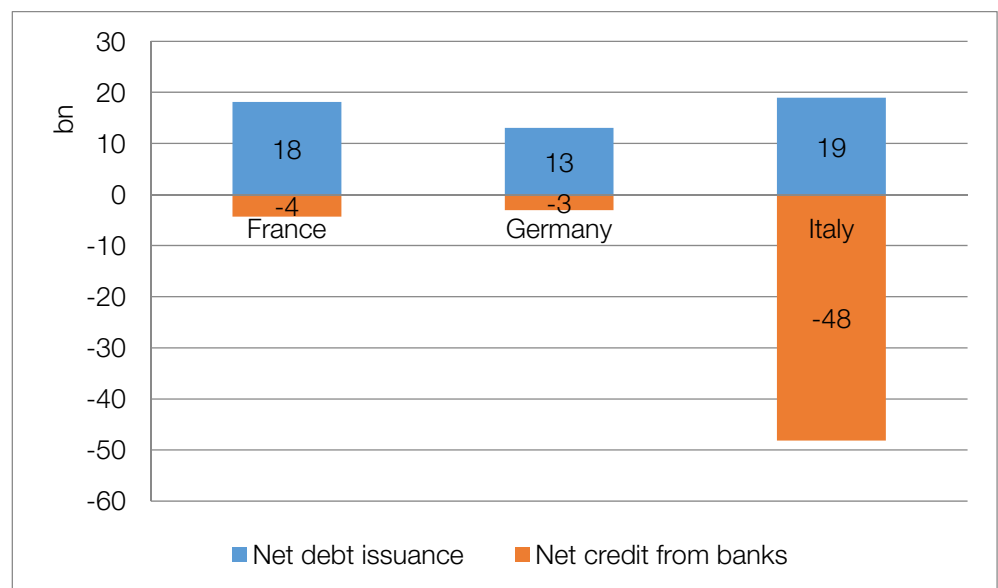
The remainder of this paper is structured as follows: in the next section we provide an overview of recent developments in company financing, in particular the changing role of investors. More specifically, we focus on the constant growth in non-bank lending and on the new instruments that are becoming available to institutional investors. Then, we offer empirical evidence on investor attitudes towards equity and debt securities issued by Italian companies based on demand-side analysis. We pay particular attention to investments in equity and debt securities issued by Italian companies as an asset class. First, we first look at new equity and debt issues to obtain direct evidence on the structure of investor demand and its evolution through a breakdown by different types of investors. Then, we shore up this evidence with an indirect assessment of investor demand for Italian equity by studying the ownership structure of publicly listed Italian companies and how it has evolved. Finally, in the last section we draw our main conclusions and offer our recommendations.

Recent Trends in Company Financing and the Role of Financial Investors in a Changing Landscape

In the last few years, the landscape of company financing has undergone substantial changes at the European level. In particular, post crisis deleveraging has been accompanied, on the debt side, by disintermediation. Companies have started to progressively substitute bank loans for corporate bonds, with institutional and retail investors stepping in to fill the corporate funding gap originated by the contraction in bank lending. In particular, an investigation by Fitch Ratings on corporate funding in Europe⁵ explored the effects of the drop in bank lending, arising from efforts to recapitalize and comply with Basel III, combined with the unprecedented conditions in corporate debt capital markets. The study found that these factors have led to bond issues accounting for a near 40% of total new debt funds in 2013, up from as low as 20% in 2007.

However, the degree of contraction in bank lending and disintermediation varies across countries. *Figure 6* shows how the funding gap is wider in Italy than in other major European economies.

FIGURE 6
Corporate funding in 2013:
Italy vs. major European
economies



Source: ECB

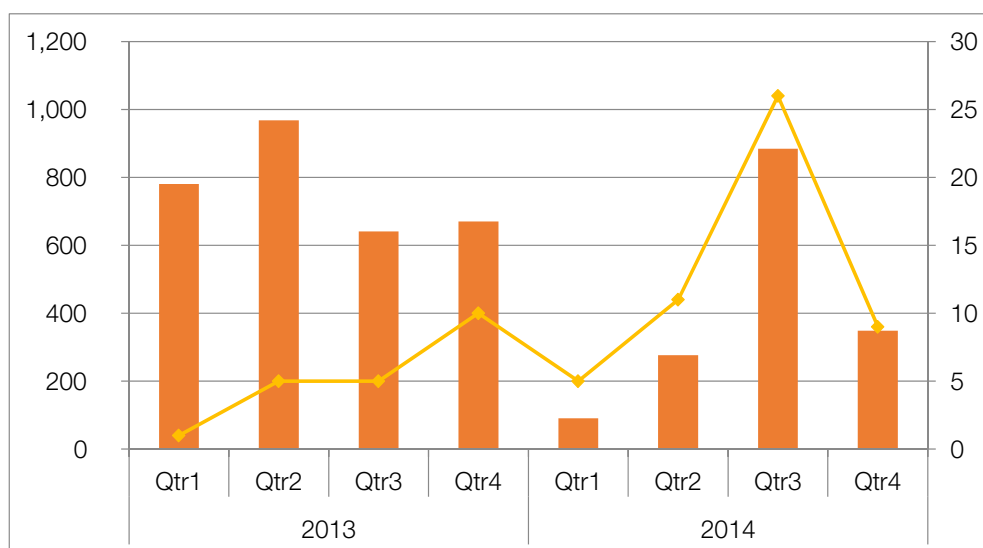
⁵ Fitch Ratings (2014), Corporate Funding Disintermediation 2Q14, Credit Market Research, EMEA April

One of the most salient implications of disintermediation is that it represents, for both retail and institutional investors, a great opportunity to broaden their scope to new investment strategies and instruments. Table 3 summarizes the typical issuers and the investors in alternative debt capital market instruments. For each one, the table also reports an estimate of the proportion of Italian companies that could potentially access each form of financing. Three major instruments are considered: Eurobonds, private placements and minibonds. Eurobonds are public bond issues by Italian companies on foreign debt capital markets, while private placements are non-public offerings, mostly to a small number of selected investors. Minibonds instead are a recently introduced tool by which SMEs in Italy can raise debt capital from institutional investors through small issues on a dedicated domestic market under less stringent regulatory conditions. Eurobonds issues and private placements are viable options only for approximately one-fifth of the companies in Italy. The only instrument that small- and medium-sized enterprises can use to access debt capital markets is the minibond, which therefore undoubtedly has the greatest potential for channeling institutional capital into corporate financing.

Instrument	Typical Investors	Typical Issuer	Breadown of Italian companies by revenue class
Eurobond	Asset managers, pension funds, insurance agencies, banks	Revenues > €500 mil	7%; approx. 330 comp.
Private Placement	U.S. PP: Insurance agencies Euro PP: Asset managers, pension funds, insurance agencies, banks	Revenues > €250 mil	13%; approx. 600 comp.
Minibond	Asset managers, banks	€80 mil < Revenues < €250 mil	87%; approx. 4290 comp.

Source: The breakdown of Italian companies by revenue class is based on balance sheet data by Mediobanca, R&S as per year 2013

Looking in more detail at minibonds, new issuances are on the rise. In fact, Borsa Italiana counts 51 new issues on its dedicated platform (Extramot Pro) since the beginning of 2014 for approximately €1.5 bn. of raised capital, as shown in Figure 7.



Source: Borsa Italiana

TABLE 3
Debt capital market instruments available to different types of investors and issuers

FIGURE 7
Number (rhs) and volume (lhs, € mil.) of new minibond issues on Extramot Pro, 2013-2014

Still, so far this asset class has been largely overlooked by some categories of institutional investors. Indeed, according to a study by Assogestioni,⁶ which investigates the potential demand for this kind of instrument, the actual holdings of illiquid assets by mutual funds, pension funds and insurance companies are well below the current regulatory limits. In this respect, Table 4 shows estimates of the potential pool of capital that could be ideally allocated to illiquid assets, such as minibonds, under the current regulatory framework. In particular, the potential contribution by each investment scheme is estimated on the basis of the proportion of assets under management that could be hypothetically allocated to SMEs adopting more or less aggressive investment styles, given the current regulatory limits on holdings of illiquid assets. According to these estimates, between €8.6 billion and €21.4 billion could be channeled into financing SMEs through these instruments, depending on the assumptions on target allocations to SMEs using different investment styles.

TABLE 4
Potential investment
in illiquid securities
by institutional investors
in 2013

	Assets Under Management €bn	Regulatory limit on illiquid assets (max %)	Assumed allocation to SMEs	Potential allocable pool € bn
Open-end Funds	534.35	10%(a)	Low: 50% High: 75%	Low: 4.11 High: 8.35
Pension Plans	39.36	20%(b)	Low: 10% High: 25%	Low: 0.79 High: 1.96
Insurance Plans	494.1	3%(c)	Low: 25% High: 75%	Low: 3.71 High: 11.1
Total	1,067.8	-	-	Low: 8.6 High: 21.4

Source: Assogestioni; (a) Regulation on collective asset management: provision of 8 May 2012 and subsequent updates; (b) Article 4, Decree 703/96 issued by the Treasury; (c) ISVAP Regulation 36/11 (Italian Insurance Regulators)

One explanation for this gap between potential and actual investments could be that direct investment in individual minibond issues may not be attractive from the standpoint of institutional investors because the typical characteristics of this instrument do not match the long term risk return objectives of their investment policies. Indeed, looking at the 73 minibonds issued on Extramot Pro since 2013, individual minibond issues are generally small scale investments that require the collection of a substantial amount of costly information. What's more, minibonds involve considerable default risk and their maturity is shorter than the typical investment horizon of institutional investors. Specifically:

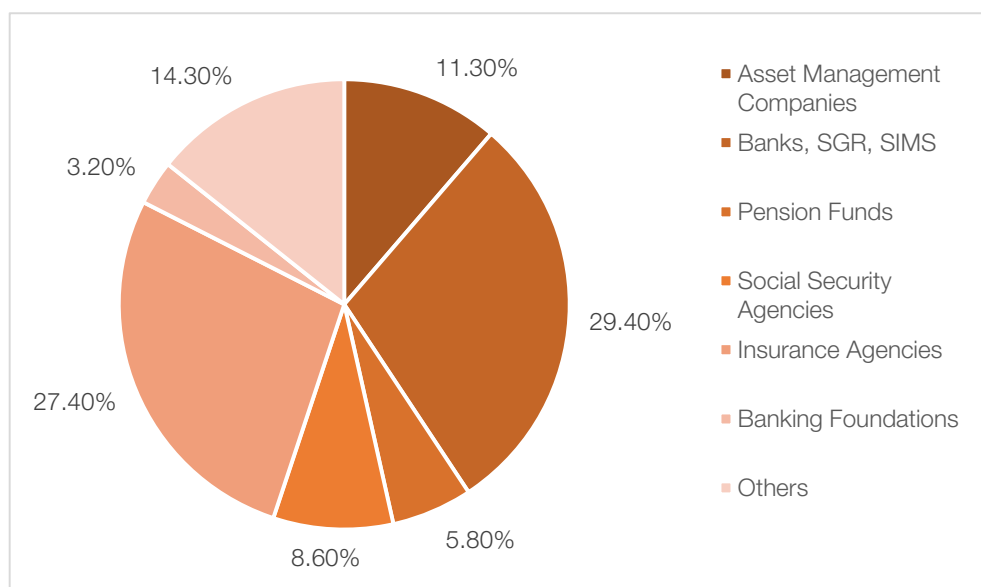
- The size of the issue is on average €63.8 million, but the median size is just €9 million.
- The issuers are generally small companies with revenues below €50 million.
- The majority of most recent issues are senior unsecured, and all covered issues are sub-investment grade.
- The maturity is commonly between 4 and 7 years.

⁶ Assogestioni (2013), L'industria del risparmio gestito ed il finanziamento delle PMI

However, indirect investment in pools of minibonds through private debt funds may well be an interesting investment opportunity for institutional investors to earn attractive returns and to diversify risks. Indeed, the offered annual coupon is above 6% for 54% of the minibonds issued so far, ranging from a minimum of 2.9% to a maximum of 10.5% with mean 6.2%, median 6% and standard deviation 1.5%.

As a consequence, while only a few years ago it would have been unusual to have institutional investors in an Italian, German or French company's lender base, today direct lending and private debt are becoming very attractive asset classes for a broader set of investors. On the one hand, the asset management industry has been quite dynamic in launching new credit funds specialized in bank loans and other private debt strategies (i.e. mid-market loans, direct lending, mini-bond and mezzanine). On the other, institutional investors, pension funds and insurance companies in primis, have also shown growing interest for this asset class, seeing it as a possible source of return and diversification of risk. Indeed, Prequin's 2014 report on private debt shows there is a growing appetite for this asset class.⁷ Global fundraising in 2014 has reached a total of more than \$37 billion by 69 funds and is likely to grow with current overall target fundraising at more than \$101 billion. Europe-focused activity accounts for 33% of global fundraising, a significant uptick compared to 21% in 2013.

Taking a closer look at the 25 private debt funds already announced in Italy according to Borsa Italiana at the end of 2014, *Figure 8* reports the contribution of different classes of institutional investors to the €1.1 billion of assets under management by these vehicles. The greatest relative contribution comes from financial institutions and insurance companies. Moreover, the absence of a strong private pension pillar seems to represent a huge unexploited potential and a drag for the full development of this asset class.



Source: Borsa Italiana

FIGURE 8
The breakdown
of major investors
in private debt funds, 2014

⁷ Prequin (2014), Prequin Special Report: Private debt, November

However, in this case too across countries the pace varies at which new investors are stepping in to fill the funding gap left by banks. According to Prometeia's report on loans and private debt funds,⁸ when compared with international standards, Italy is once more lagging behind. Indeed, taking for example Italian pension funds, they allocate on average only 2% of their investment to corporate debt, while the corresponding figure for Germany and the UK is 20% of a much larger capital base as pension funds in these countries are approximately twenty times larger. To get a clearer picture of the current state of affairs as far as the contribution of institutional investors to corporate financing, Table 5 reports the breakdown of the aggregate portfolio at the end of 2013 of different types of domestic institutional investors, highlighting their direct investments in equity and debt securities issued by Italian companies, as well as their allocation to Italian mutual funds. In relative terms, the size of the portfolios of domestic institutional investors is much smaller than that of foreign institutional investors. For example, in Italy domestic institutional investors account for just 8% of the stock market capitalization while the corresponding figure in the UK is 30%. Still, the aggregate numbers provide evidence of a largely underexploited potential. Out of an aggregate pool of more than €1 trillion of invested capital, only 6.1% and 6.2% are directly invested respectively in equity and debt securities of Italian companies.

TABLE 5
The breakdown
of portfolios of Italian
institutional investors
in 2013

	Italian Equity Securities	Italian Debt Securities ^a	Italian Mutual Funds Shares ^b	Totals	Assets Under Management
Asset Management Companies	4.4 € bn 15%	7.2 € bn 25%	17.4 € bn 60%	29.0 € bn 100%	143.29 € bn
Banks, SGR, SIMS	23.9 € bn 34%	32.6 € bn 46%	14.1 € bn 20%	70.6 € bn 100%	639.6 € bn -
Pension Funds	0.7 € bn 5%	1.4 € bn 11%	10.9 € bn 84%	13.0 € bn 100%	86.0 € bn -
Social Security Agencies ^c	1.9 € bn 8%	5.6 € bn 22%	17.5 € bn 70%	25.0 € bn 100%	61.1 € bn -
Insurance Companies	57.8 € bn 32%	43.6 € bn 24%	81.3 € bn 44%	182.7 € bn 100%	541.8 € bn -
Banking Foundations ^d	n.a. -	n.a. -	n.a. -	n.a. -	26.8 € bn -
Totals	89.6 € bn 28%	91.7 € bn 28%	143.9 € bn 44%	325.3 € bn 100%	1.5 € tn -

Source: Banca d'Italia⁹, CONSOB¹⁰, COVIP¹¹, ACRI¹²; ^a Debt securities are not inclusive of sovereign debt; ^b Mutual fund shares can include also holdings in Italian funds that invest in foreign securities; ^c the figures for Social Security Agencies are inclusive of equity and debt securities by foreign issuers; ^d the figure for Banking Foundations refers to financial assets on the balance net of the holdings in the participated bank.

Moreover, Figure 9, which compares the asset allocation to Italian equity and debt securities of different Italian institutional investors, clearly indicates the small contribution of institutional investors to direct corporate financing. Particularly noteworthy is the absence in Italy of a strong institutional investment base from private pensions, which represent instead one of the key players in other major economies.

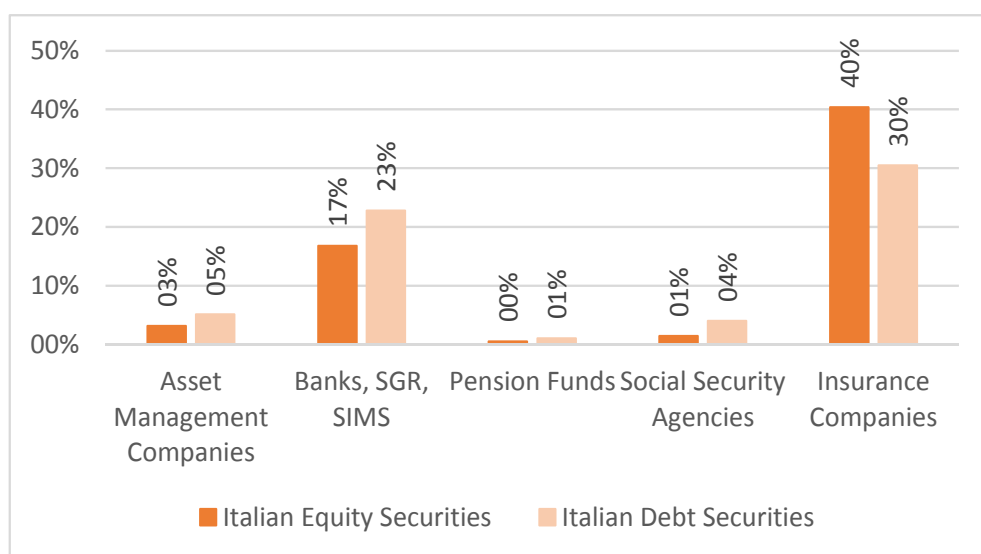
⁸ Prometeia (2014), Loans and private debt funds: Products features and market trends

⁹ Banca d'Italia (2014), Annual Report 2013

¹⁰ CONSOB (2014), Statistical Bulletin, September

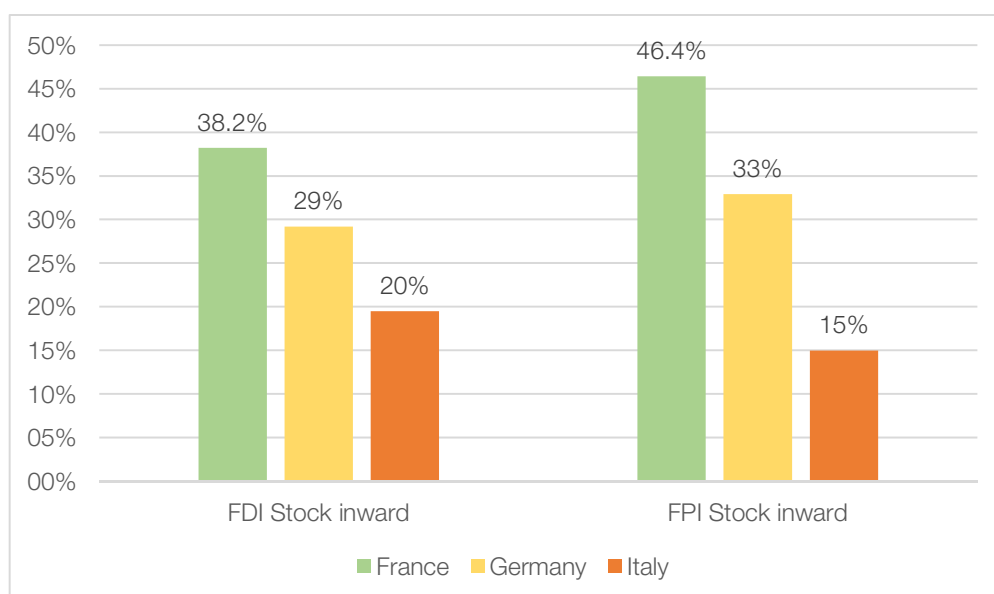
¹¹ COVIP (2014), Annual Report 2013

¹² ACRI (2014), Annual Report 2013



Source: Banca d'Italia, CONSOB, COVIP, ACRI. Detailed data on the breakdown of the financial assets on the balance sheet of banking foundations is not available.

In addition to that, the whole Italian system is unable to effectively attract foreign investments. According to the Borsa Italiana more than 1300 asset management companies are currently investing in Italian stocks listed on the FTSE MIB from 45 different countries through more than 7000 funds. Still, Italy attracts little foreign equity investment compared to its European neighbors. *Figure 10* measures the level of foreign direct investment (FDI) and foreign portfolio investment (FPI) in Italian equities, as a percentage of GDP, with respect to other major European economies. The first measure captures investments in Italian companies by foreign investors with a significant degree of influence and control, while the latter refers to Italian securities and other financial assets passively held by foreign investors. The evidence demonstrates that Germany and France are much more attractive for foreign investors than Italy, further widening the Italian funding gap. The volumes of both foreign direct investment and foreign portfolio investment in Italian equities are substantially smaller than the volumes of other major European economies.



Source: OECD, IMF Coordinated Portfolio Investment Survey

FIGURE 9
Allocations to Italian equity and debt securities by different Italian institutional investors, 2013

FIGURE 10
Foreign direct investment (FDI) and foreign portfolio investment (FPI) as a % of GDP for Italy and major European economies, 2013

A Demand-Side Empirical Analysis of Investor Appetite for Debt and Equity Securities of Italian Companies

Is the disconnection between Italian companies and capital markets due to a lack of interest among investors in equity and debt securities issued by Italian companies? Or are companies unable to tap into these pools of capital?

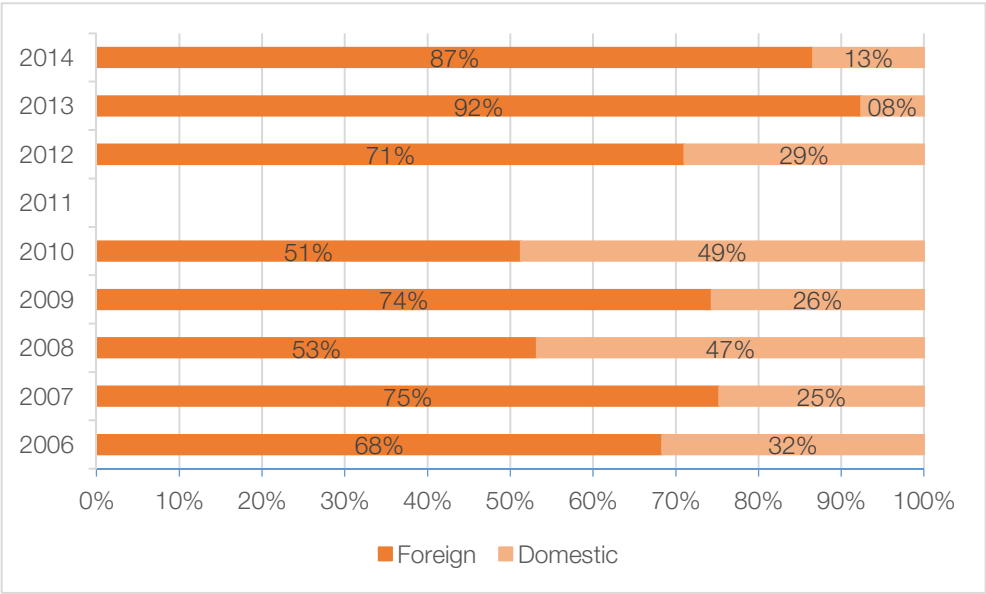
The aim of our empirical analysis is to disentangle these two potential drivers of the communication breakdown between Italian companies and capital markets. We do so by studying in more detail the attitudes of investors toward equity and debt securities issued by Italian companies in an effort to assess the potential demand for this investment class. Ultimately we seek to understand the possible role of capital markets in financing Italian companies.

The breakdown of investor demand for newly issued debt and equity securities of Italian companies

To obtain direct evidence on the structure and evolution of investor demand for Italian securities, we take a closer look at new equity and debt issues. In particular, we collect data on demand for new debt and equity securities issued by Italian companies during the book building phase; we then break down this demand by different types of investors. The ultimate goal is to clarify the contribution of various categories of investors to aggregate demand.

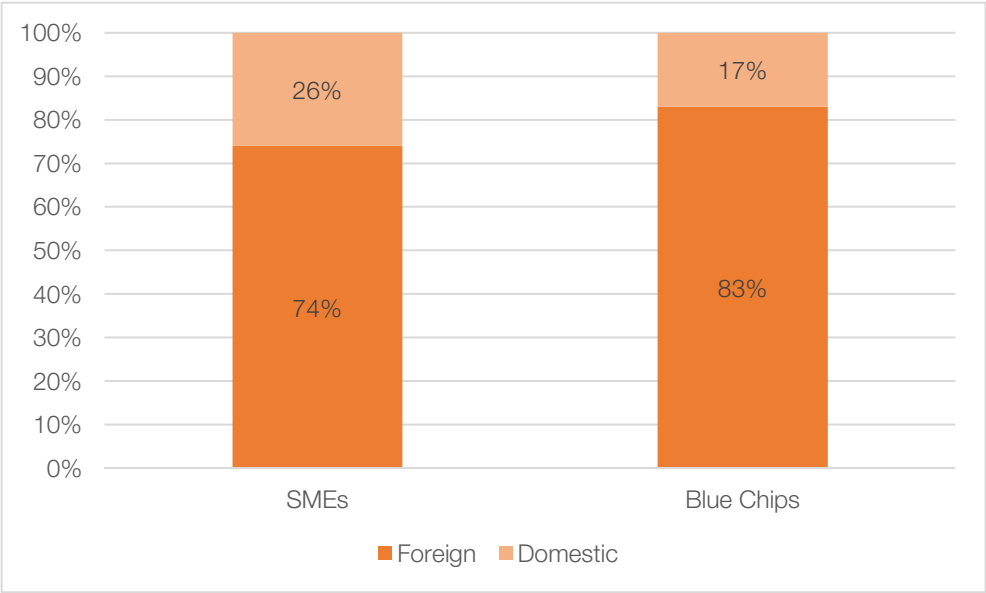
We first look at equity issues. Our sample includes the 50 IPOs on the Borsa Italiana MTA dating from 2006 to 2014 with deal values in excess of €10 million. Our analysis of investor demand for newly issued equity securities of Italian companies focuses on the proportions of shares allocated to different groups of investors, classified on the basis of their nationality and their institutional or retail profile. We built the sample by collecting data directly from press releases published by the issuing companies.

Figure 11A shows the relative allocations to domestic and foreign investors. Overall, the share of Italian investors is clearly much smaller than the contribution of foreign investors. Only when deals are limited and their size is small, the proportion of shares allocated to Italian investors grows. This may well be striking evidence of the limits of the domestic investment base, especially if we consider that the stock of foreign portfolio investments toward Italy is smaller than for other major European economies, as already shown in *Figure 10*. As a consequence, when IPO volume and deal size picks up, foreign investors take the lead. Indeed, in the last few years, as IPO activity has started to regain momentum, we observe that the allocations to domestic investors have diminished.



Source: Baffi Carefin Università Bocconi

Figure 11B shows that the allocation to foreign investors is predominant, regardless of the size of the deal. Blue Chips are larger companies, with market capitalization greater than €1 billion, while those companies with a market capitalization below €1 billion are labeled SMEs. The presence of foreign investors compared to Italian investors is only slightly more significant in deals consisting of larger issues (83%) compared to smaller ones (74%).



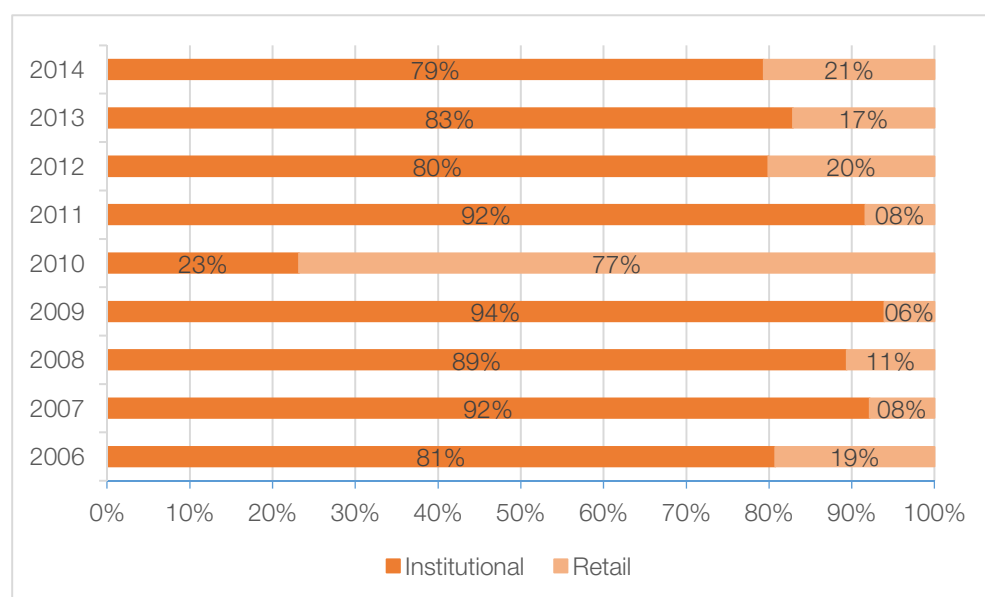
Source: Baffi Carefin Università Bocconi

An additional insight into investor demand for newly issued equity is provided in Figure 12A, which shows the relative allocations to retail and institutional investors. Overall, the share of retail investors is much smaller than the contribution of institutional investors. The observation for 2010 is an outlier related to the ENEL Green Power IPO that took place in that period. Taking into account also the evidence highlighted in Figures 11A and 11B, the dominance of institutional investors in the allocation of newly issued equity securities seems to indicate that the major limit to the domestic investment base can be found in the lack of a solid institutional pillar.

FIGURE 11A
Allocation to different
investors: domestic
vs. foreign, 2006 – 2014

FIGURE 11B
Allocation to different
investors according
to the size of the issue:
domestic vs. foreign,
2006 – 2014

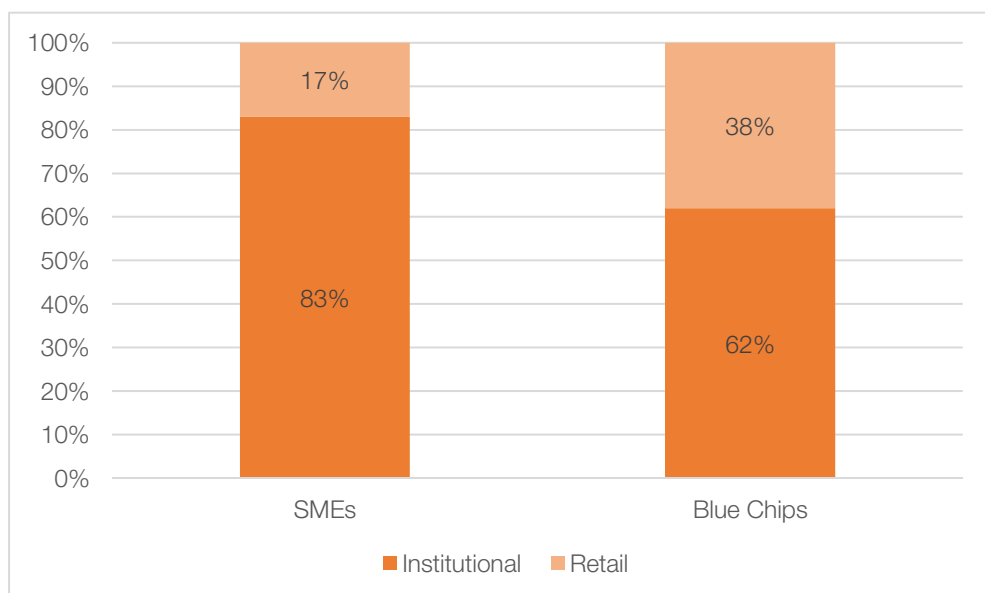
FIGURE 12A
Allocation to different
investors: retail vs.
institutional, 2006 – 2014



Source: Baffi Carefin Università Bocconi

Figure 12B shows the proportion of retail and institutional investors in IPOs undertaken by Blue Chips and SMEs. For Blue Chips, a more balanced proportion between the two emerges. Specifically, institutional and retail investors maintain a ratio of 60:40. For SMEs, in contrast, an 80:20 ratio applies. Therefore, it is clear that retail investors are more concerned about SME risk, and at the same time they are more attracted by larger (and safer) companies for which they can easily make informed investment decisions. On the other hand, institutional investors look proactively at SMEs, trying to cash in on higher expected returns.

FIGURE 12B
Type of investors:
SMEs and Blue Chips,
2006 – 2014



Source: Baffi Carefin Università Bocconi

In any case, the final allocation to any particular class of investors is simply an indirect proxy of actual demand. This means that analyzing demand exclusively on the basis of allocated shares is prone to potential biases to the extent that strategic and commercial considerations concur to determine whether and how any investor demand is satisfied, either fully or partially. So we need to confirm our findings with direct observations of demand, which also allows us to further break institutional demand down across different classes of investors according to their relative contribution. To do so, we study a restricted set of equity market transactions for which we have access to book data. In particular, our sample consists of 18 deals, including IPOs, SEOs and ABBs, that occurred between 2009 and 2014. *Figure 13* shows the geographic breakdown of demand across domestic and foreign investors. Also in this case, the contribution to overall demand by Italian investors is much smaller than that of foreign investors, confirming the limits of the domestic investment base. As a consequence, especially in the last two years when deal volumes and size have picked up, foreign investors have stepped in to fill the gap in domestic demand.

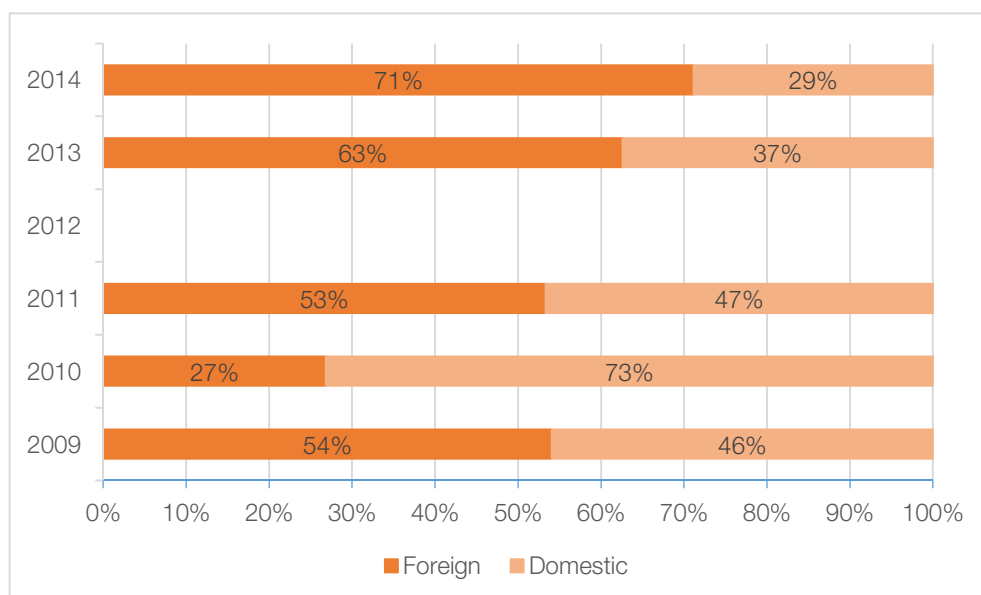


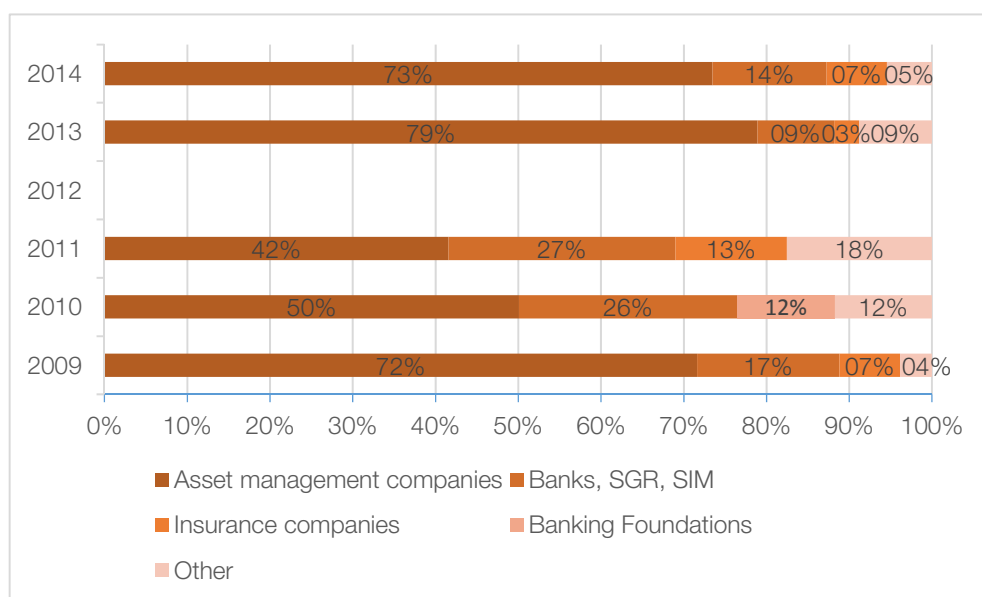
FIGURE 13
Book breakdown
by investor nationality,
2009 – 2014

Source: Baffi Carefin Università Bocconi

Figure 14 and *15* break down institutional demand respectively across different classes of investors and their investment styles. In this respect, we observe the preponderant contribution to the demand for Italian equity investment comes from investment vehicles related to asset management companies, banks, SGRs, SIMs and insurance companies. This result is consistent with the ability of Italian equity as an investment class to attract a wide range of institutional investors with different profiles. Indeed, a broad variety of investment styles contributes to the demand for this instrument, but most of the capital provided is linked to GARP (i.e. Growth at Reasonable Price) strategies.¹³ However, our analysis also confirms the lack of a large private pension investment pillar in Italy, which currently contributes only residually to institutional demand. As such, this represents a huge unexploited potential as well as a drag for the full development of the domestic equity market.

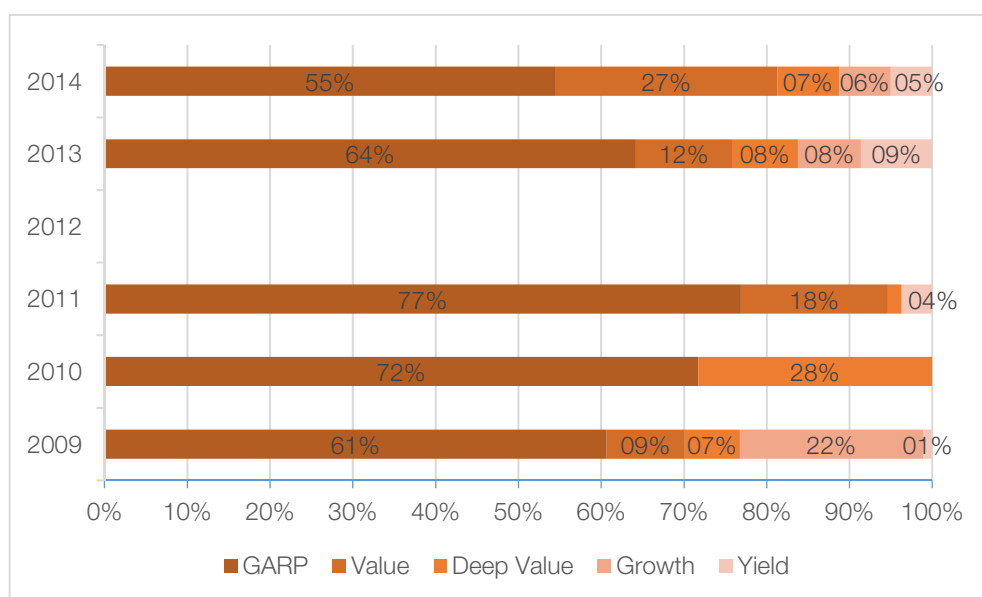
¹³ GARP is an investment strategy based on a mix of growth and value investing, i.e. looking for companies with above average earnings growth and undervalued valuations. Damodaran, Aswath, *Growth Investing: Betting on the Future?* (July 27, 2012).

FIGURE 14
Book breakdown
by institutional investor
profile, 2009 – 2014



Source: Baffi Carefin Università Bocconi

FIGURE 15
Book breakdown
by institutional investment
style, 2009 – 2014



Source: Baffi Carefin Università Bocconi

A confirmation of the challenging environment for equity investment in Italy emerges also by looking at the Alternative Investment Market, where demand by investors is sluggish. Table 6 provides the list of new issues on AIM Italia in 2014. Even if the volume of deals has hit a record high during the year, in more than 50% of the IPOs the size of the issue had to be substantially reduced, on average by 45%, due to the lack of demand by investors.

	IPO Date	Issue Size € mln.	Reduction %
Gruppo Green Power	22/01	3.3	-
Expert System	18/02	17.1	-
Gala	10/03	24.8	43%
Triboo Media	11/03	24.0	-
Agronomia	06/05	6.2	50%
Ecosuntek	06/05	5.3	67%
Energy Lab	20/05	3.7	8%
Plt Energia	04/06	10.5	50%
Methorios Capital	23/06	7.0	39%
Mp7 Italia	07/07	4.0	-
Iniziative Bresciane	15/07	22.6	-
Lucisano Media Group	16/07	6.4	39%
Blue Note	22/07	1.0	-
Mailup	29/07	3.0	-
Tech-Value	05/08	1.7	63%
Go Internet	06/08	5.0	58%
Tecnoinvestimenti	06/08	22.8	37%
Bio-on	24/10	6.9	43%
Modelleria Brambilla	5/12	n.a	n.a
Axelero	11/12	n.a	n.a

Source: Borsa Italiana

TABLE 6
IPOs on AIM Italia, 2014

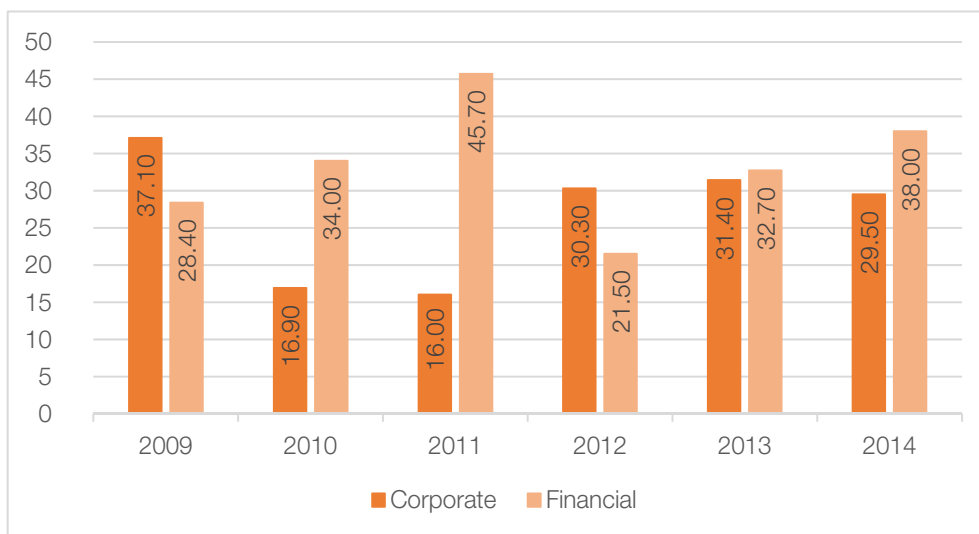


FIGURE 16A
Demand by type of issuer,
2009 – 2014

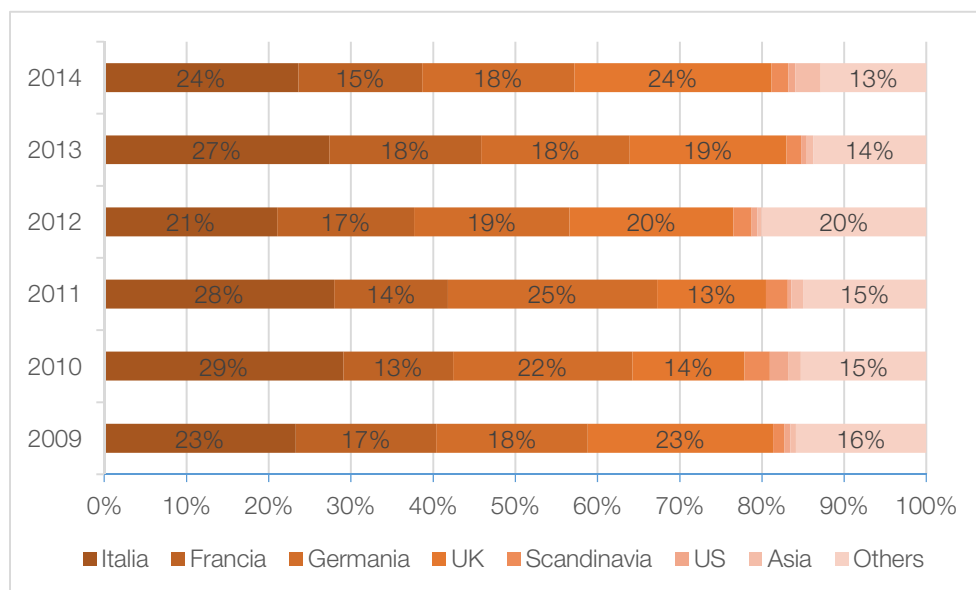
Source: Baffi Carefin Università Bocconi

Analogous inferences can be drawn by looking at newly issued bonds. We consider a sample that includes 186 different bond issues by Italian companies in the period between 2009 and 2014. Our analysis of investor demand for debt securities newly issued by Italian companies focuses on the relative contributions to the book by different groups of investors, classified on the basis of nationality and profile. We retrieved relevant data from Bondradar, a debt capital market data provider widely used among professionals.

To begin, we report in *Figure 16A* the description of investor appetite for bonds newly issued by financial and corporate companies from 2009 to 2014.

Figure 16B shows the relative contribution to the book building by domestic and foreign investors. Overall, the share of Italian investors is on average just one-fifth of the contribution of foreign investors. This evidence clearly reflects the limits of the domestic investment base. However, a related factor is the inadequacy of the domestic capital market, which has favored the development of foreign markets dominated by large foreign investors. In addition, a closer look at the individual issues shows that access to these markets is restricted only to larger Italian companies. Instead the majority of medium- and small-sized companies, which are the backbone of the Italian economy, are left out of this form of financing.

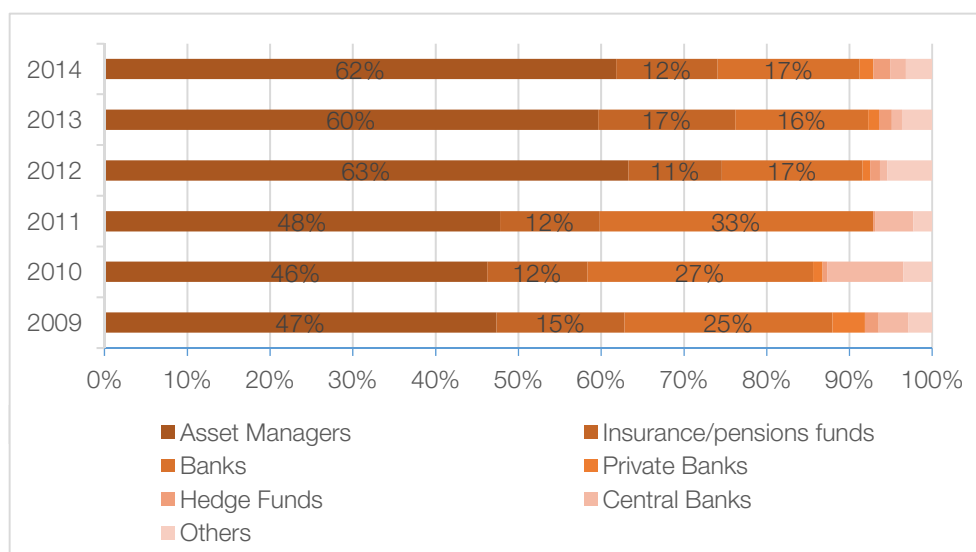
FIGURE 16B
Book breakdown
by investor nationality,
2009 – 2014



Source: Baffi Carefin Università Bocconi

A further insight onto investor demand for new debt securities issued by Italian companies is provided in Figure 17, which shows the relative contributions to book building by different types of investors, classified on the basis of their profile. Overall, the breakdown of institutional investors' demand for newly issued debt securities seems to indicate a strong interest in this investment class by asset managers, banks and insurance/pension funds.

FIGURE 17
Book breakdown
by investor profile,
2009 – 2014



Source: Baffi Carefin Università Bocconi

The ownership structure of publicly listed Italian companies

With respect to investor demand for the equity of Italian companies, we complement the direct evidence from the breakdown of investor demand for newly issued securities with an indirect assessment of said demand by studying the ownership structure of publicly listed Italian companies and how it has evolved.

More specifically, we focus our analysis on the comparison between the composition of the shareholders' group in Blue Chips and SMEs. The sample we consider includes all companies with stocks traded on Borsa Italiana MTA between 2006 and 2014, classified on the basis of their market capitalization at the relevant date. As mentioned before, Blue Chips are larger companies with market capitalization greater than €1 billion, while those companies with a market capitalization below €1 billion are labeled SMEs.

We first look at differences in the liquidity of stocks across our two groups of companies. *Figure 18* shows the floating stocks for both Blue Chips and SMEs. The larger firms are characterized by a higher percentage of outstanding shares available for trading, meaning that their liquidity is higher than that of SMEs. In addition, as far as SMEs are concerned, float has been decreasing since the financial crisis.

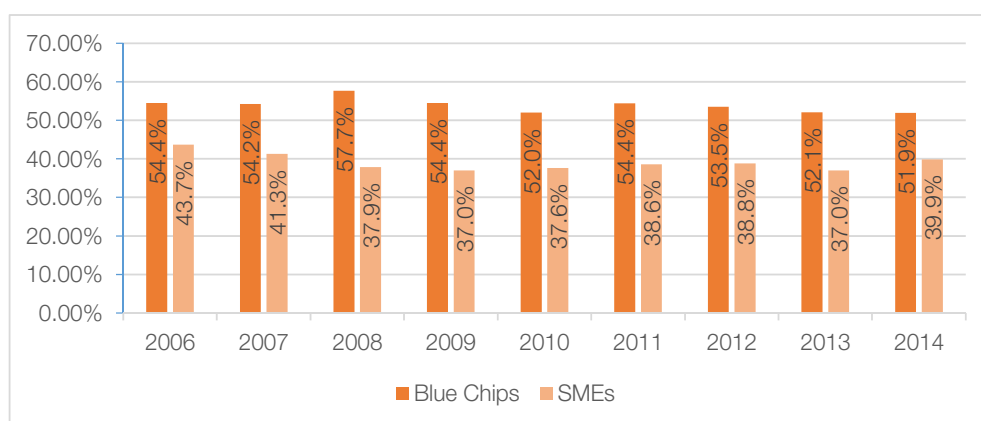
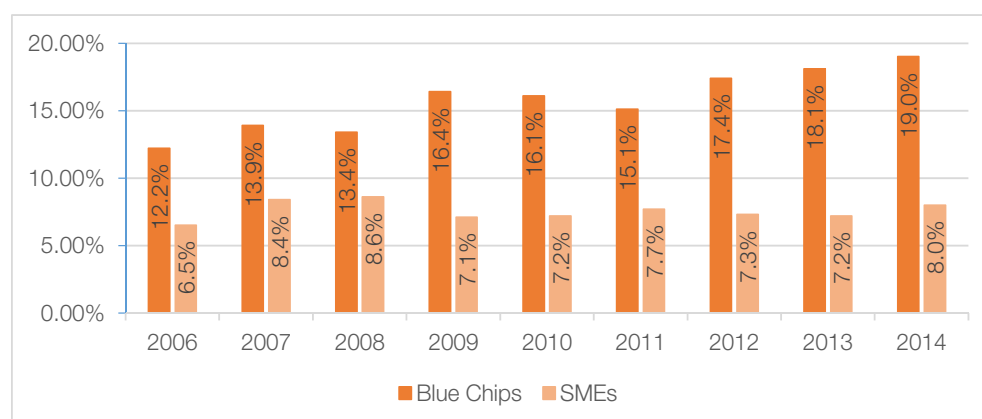


FIGURE 18
Blue Chips and SMEs
float (%), 2006 – 2014

Source: Borsa Italiana

Next we look at the relative contribution of both domestic and foreign institutional investors to the shareholder base across our two groups of companies. *Figure 19* shows the proportion of shares held by institutional investors over time for both Blue Chips and SMEs. Evidence shows that institutional investors have gradually increased their presence in the ownership structures of larger companies. Indeed, their share has grown from 12% to 19%. On the other hand, SMEs remain prevalently family owned or restricted to a smaller number of investors.

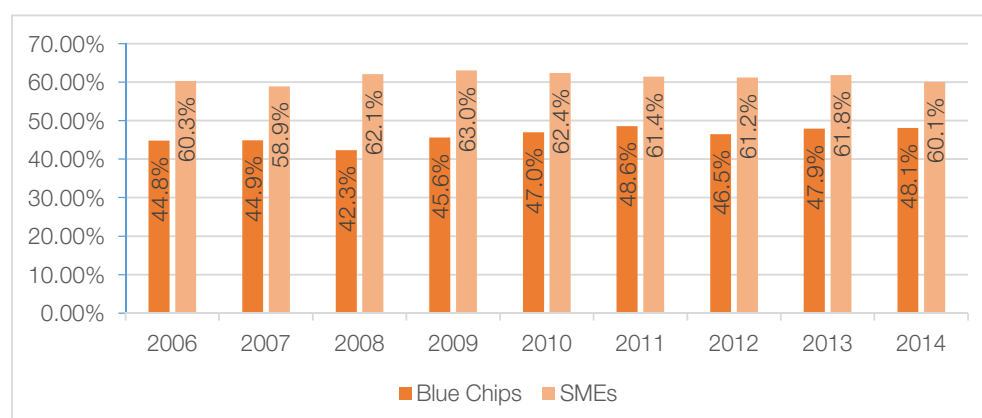
FIGURE 19
Blue Chips and SMEs:
institutional holding as %
of share capital,
2006 – 2014



Source: Borsa Italiana

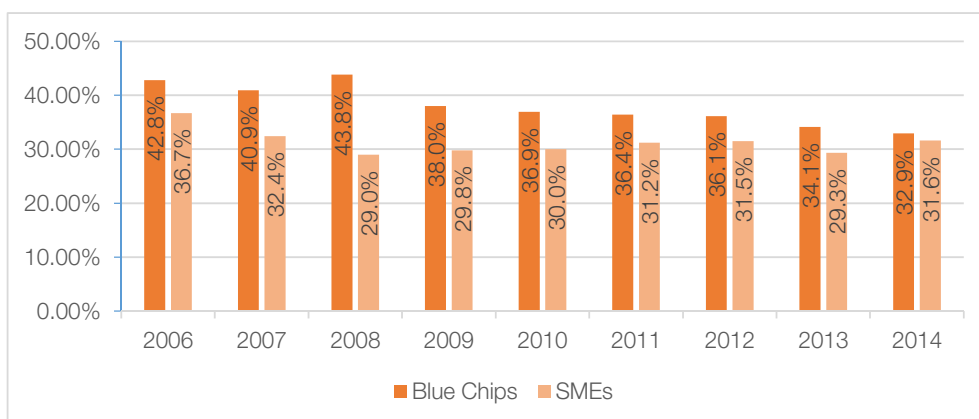
As a complement to the role of institutional investors, we then look at the relative contribution of insiders or stakeholders to the shareholder base across our two groups of companies. *Figure 20* shows the proportion of float held by insiders or stakeholders over the sample period. Although the contribution of insiders and stakeholders to the ownership of Blue Chips and SMEs is fairly stable over time, a comparison across groups shows that for the latter a much higher percentage of share capital is held by insiders (60% vs 45%). It follows that Blue Chips are less reluctant to accept outside investors (both foreign and domestic).

FIGURE 20
Blue Chips and SMEs:
insider/stakeholder
holdings as a %
of share capital,
2006 – 2014.



Source: Borsa Italiana

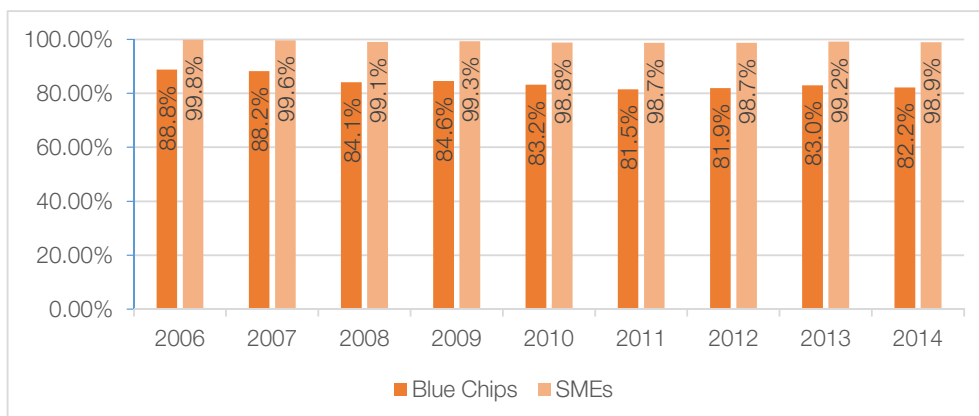
On the basis of the contributions of institutional investors and insiders, it is possible to come up with an estimate of the implicit contribution of retail investors. *Figure 21* shows the implied proportion of float held by retail investors over the sample period. Evidence clearly shows a converging trend between retail investors' contributions to the ownership structure of Blue Chips and SMEs in the post financial crisis period.



Source: Borsa Italiana

We then examine in more detail institutional holdings. Our aim here is to understand more fully the concentration or dispersion of their stakes in Italian companies, their nationality, and the relative contribution of different categories of institutional investors.

In this respect, *Figure 22* analyses the weight that the top 25 institutional investors have on the total percentage they hold. Here too it is interesting to note the differences between Blue Chips and SMEs. Indeed, the top 25 investors represent only 80% of the total share of Blue Chips, while for SMEs they represent almost the entirety. This result is confirmed if we consider for example only the first 10 investors. Therefore, this finding seems to indicate that Blue Chip companies have a wider range of investors, while the institutional holdings of SMEs are more concentrated in the hands of a few large investors.



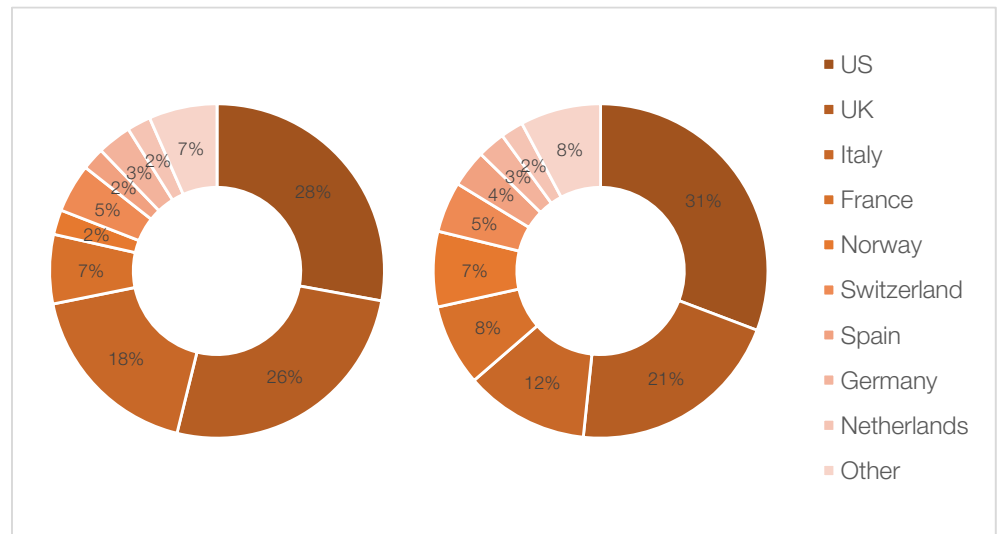
Source: Borsa Italiana

As far as the geographic breakdown of the institutions investing both in Blue Chips and SMEs, *Figure 23* compares the relative contribution of foreign and domestic institutional investors in 2006 and 2014. US investors represent more than 30% of the total institutional holdings, and their share has been increasing over time. Interestingly, Italian institutional investors decreased from 18% to 12% over the sample period. The preponderance of foreign institutional investors in the float of Italian companies reflects one of the major fragilities of the system. This calls for a stronger base of domestic investors to step in to reduce the dependence of Italian companies on bank lending and to guarantee the feasibility of strategic operations on equity capital markets such as privatizations.

FIGURE 21
Blue Chips and SMEs:
retail holdings as a %
of float, 2006 – 2014

FIGURE 22
Blue Chips and SMEs:
holdings of top 25 investors
as a % of their total
holdings: 2006 – 2014

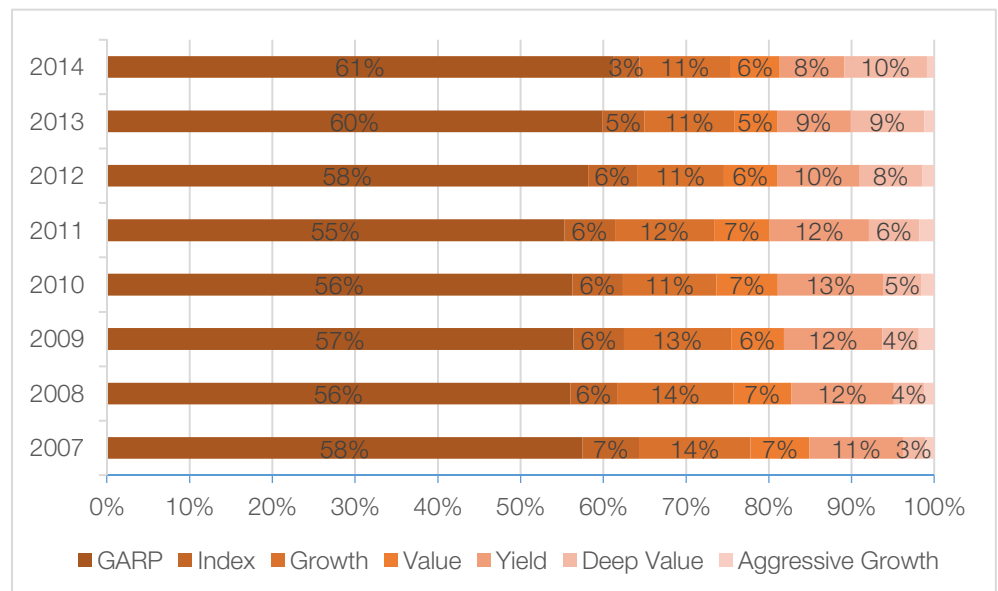
FIGURE 23
Geographic breakdown
of institutional investors:
2006 vs 2014



Source: Borsa Italiana

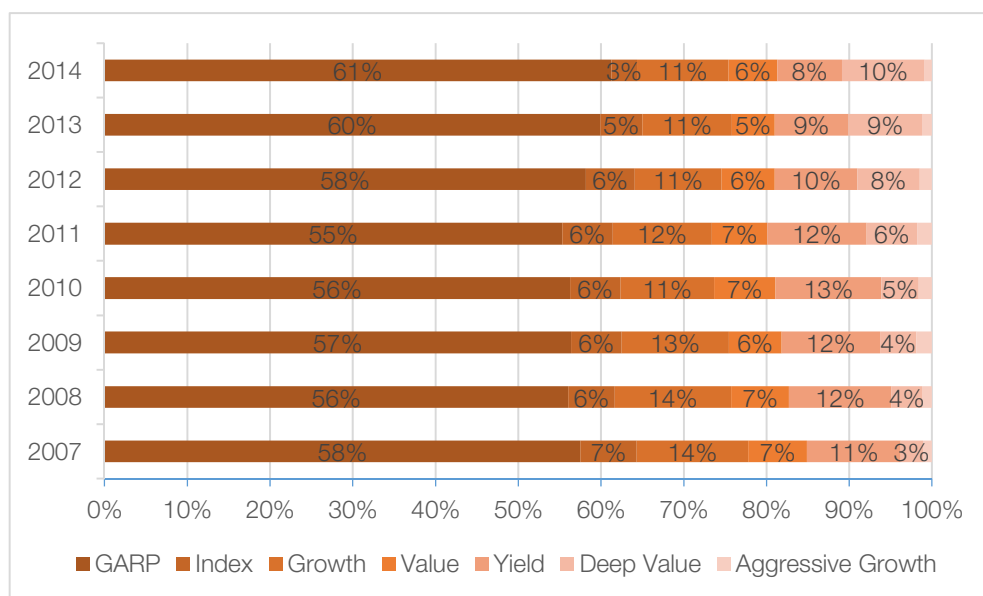
With regard to the type of institutional investors holding stock in Italian companies in their portfolios over time, *Figure 24* breaks down total holdings across major investors, as classified by Borsa Italiana. The main trend that emerges is that speculative, risk-seeking investors (hedge funds) have been gradually decreasing their exposure over time. In contrast, investment advisors (more oriented at preserving capital for their clients) and Sovereign Wealth Funds have increased their relative contribution. Added to this, once more we find striking evidence of the absence of a strong private pension pillar, which limits the Italian institutional investor base.

FIGURE 24
Breakdown of institutional
investors by type,
2006 to 2014



Source: Borsa Italiana

Finally we complete our analysis of institutional holdings by breaking them down by investment style, as shown in *Figure 25* based on Borsa Italiana classifications. Consistent with results regarding investor types, the contribution of institutional investors who adopted GARP styles (Growth at reasonable price) slightly increased over time. Instead both investors with Growth and Yield strategies decreased their contribution in the aftermath of the financial crisis. Along the same lines, the holdings of investors with a Deep Value investment style dramatically increased. The opportunity to buy stocks cheap and hold them through the financial and sovereign debt crisis has apparently been the main driver for investors' appetite for Italian equities.



Source: Borsa Italiana

FIGURE 25
Breakdown of institutional
investors by investment
style, 2006 to 2014

Conclusions and Recommendations

The picture that emerges from our analysis is enriched with relevant data, and serves as a helpful tool for verifying the current state of affairs with regard to Italian securities. However, our findings do not allow us to make a clear statement as they are replete with ambiguity. The origin of this ambiguity is the role and the perspective of foreign investors in Italian companies, both as securities buyers and securities holders. If these figures are truly impressive, so too is the absence (or, the less relevant presence) of Italian investors.

Italian companies cannot access capital markets without a strong domestic investor base. Indeed foreign capital is currently channeled almost exclusively into a limited set of large companies which do not accurately represent the Italian productive system. Following the example of other financially developed countries, Italy needs to adopt specific policies to promote investments in productive assets through the capital markets. The greatest potential lies in so-called minibonds. Large scale development of these instruments could provide wide access to debt capital, but current statistics are not encouraging. Looking at the shareholder base of Italian companies, US investors represent more than 30% of the total foreign institutional holdings. Their holdings have been increasing over time to the detriment of Italian institutional investors, whose share shrunk from 18% to 12% in the period between 2006 and 2014. Therefore, the preponderance of foreign institutional investors represents one of the foremost fragilities of the system. This calls for a more solid base of domestic investors to step in to reduce the dependence of Italian companies on bank lending and to guarantee the feasibility of strategic operations on equity capital markets, to include privatizations.

On the one hand, considering this scenario of foreign investors in Italy, it's quite positive (even more than positive) to discover just how relevant the presence of investors coming from outside the domestic arena is. But the reasons for this strong presence could be related to a mix of different factors, all of them not necessarily positive: a discount on equity values of Italian companies; a low (or relatively low) level of multiples; the potential upside embedded into companies to be restructured; an abundance of liquidity and the need for fund managers to rotate asset allocation; the ambition to buy trophy assets, which are quite abundant and attractive in Italy. Obviously more favorable interpretations could be put on the table: the solidity of the Italian system; the capacity to lead reforms; the very high quality of many Italian companies and the perennial value of Made in Italy; a bet on renewed Italian growth.

That's why on the other hand the future is not clear, and the risk remains that foreign money will suddenly disappear. It's easy to fall in love, but just as quick and easy to fall out of love again. To avoid this concrete risk, many actions have to be taken in Italy. Leaving aside for a moment macroeconomic and political issues (even though they are highly relevant and crucial in the game of attracting investors) we can focus on a very concrete and complex portfolio of tools/policies where the common goal is to multiply the presence of domestic investors and to reduce the possibility that foreign investors might disappear.

On the domestic investor side, the main actions to organize and activate are related to four aspects:

- i) Enforcing the presence of Italian investors, both retail and institutional. This can only happen if the long process that started some decades ago with the creation of an asset management industry (and of a private banking industry as well) continues, moving forward to encourage Italian investors (wholesale and retail) to see the Italian market as a reasonable arena, one where investing makes good business sense.
- ii) Promoting a fund of funds mechanism especially to sustain minibonds, whereas developing a large market of smaller securities could be supported only by a strong platform of money earmarked for investing with a specialized approach adopting a medium-long perspective. In this way, the fund of funds mechanism can encourage the emergence of specialized players able to run a more comprehensive professional screening process on smaller issuers. This would mean offering the market the possibility to invest without having a deep and at times complex involvement in smaller companies.
- iii) Driving traditional bank lending to sustain the use of securities, as banks have to balance the need to reduce capital impact, with the need to maintain and better exploit customer relationships. Offering professional services to issue securities more and more extensively is the real way to legitimate the presence of traditional universal banks with stronger constraints of capital adequacy. Customers who use securities more frequently could improve their rating profile and in turn their impact on capital adequacy, allowing banks to give more loans.
- iv) Promoting the variety of financial intermediaries devoted to capital markets: the securities industry needs financial institutions with extensive know how in managing the entire value chain of issuing-distributing-managing securities. In the past, the presence of universal banks completely crowded out of the market specialized institutions, which again today have become relevant, even crucial.

On the foreign investor side, more actions have to be put in place, further strengthening the presence of domestic investors, as described above. The most relevant actions can be summarized into three initiatives:

- i) Enforcing the rights and the protection of foreign investors (or, more in general, of institutional investors). The risk of a downturn and changes in the legal system (and the fiscal system) is very high in Italy. This represents a clear point investors can use to justify escaping suddenly from the country, or avoiding investing here altogether. The options that can be designed and discussed maintain the current regulatory framework of rights and duties of investors and/or the current setup of guarantee schemes.
- ii) The “double vote system” or the “dual class system” within shareholder groups could represent the right incentive for investors who are willing to bet on a company (or a country), and who have a medium-long term perspective within the corporate governance of a firm (not necessarily a large one).
- iii) A fundraising platform: It is urgent to make Italy attractive for global investors; this must drive policy makers to set up a proper fundraising task force at a government level, one which is able to represent the entire Italian economic system and to promote investments in Italy. A systematic approach to illustrating the strengths of the country has to prevail over a simple random one, grasping opportunities and making money from time to time.

The final factor to consider is the role of rules and tax incentives. A large, effective, and functional equity and bond capital market has been shored up by a supportive tax system. The aim is not to waste money but to invest money through tax incentives based on the conviction that the capital market is an asset for the country and a relatively cheap tool (as compared to industrial policy) for sustaining company growth. Tax incentives have to be well organized along the value chain that links the different stages of the relationship between the capital market and the company (i.e., pre-IPO, IPO, grace period post IPO, listed company) with the different players involved (i.e., the investors who could be classified into equity investors, private “pure” investors, private “owners”, institutional investors) and the company itself. Till now the responsiveness of policy makers was based on the ACE mechanism. We believe more challenging (and aggressive) decisions could be taken to reduce the tax burden of companies facing IPOs and investors putting their commitment on the table.

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APPENDIX: An Overview of the Fiscal and Normative Framework for Equity and Debt Investors and the Most Recent Developments

The process of simplification of the regulatory framework of SMEs in Italy aiming to go public or seek new forms of financing on the capital markets has been of crucial importance in the bank-centric financial system in recent years. In particular, many initiatives have been implemented to shore up the economy and encourage SMEs to seek out alternative capital raising opportunities.

Equity Side

On the equity side, the most important steps in this direction refer to the creation of the AIM Italia in December 2008 and the new Competitiveness Decree (Decreto Competitività) which came into force in August 2014.

AIM Italia is a MTF (Multilateral Trading Facility) fully dedicated to small and medium enterprises with high growth potential. It was originally created for the purpose of broadening the array of opportunities specifically reserved for SMEs seeking external funding on the capital markets, thus reducing their dependence on the traditional channels of bank lending. The new facility is based on the AIM UK, the London Stock Exchange's market for small and medium enterprises which has been growing enormously since its inception in 1995. Its Italian counterpart aims at providing some key benefits:

1. A more flexible approach in term of cost and timing, while maintaining adequate investor protection and transparency.
2. A broader base of investors looking for returns (both institutional and retail).
3. Easier access to international capital markets.

AIM's success depends on its flexible structure and the slim and concise regulatory framework it is based on, in particular the admission criteria and the continuing obligations a SME has to meet before, during and after its listing. *Table A* summarizes the main differences between AIM and the MTA for larger companies.

	AIM	MTA
Pre-admission		
Minimum free-float	10%	25-35%
Minimum market capitalisation	No	€40 - €1,000 mln
Track record requirement	No	3 years
Advisor	Nomad	Sponsor
Certified financial statements	1 (Italian GAAP or IAS/IFRS)	3 (at least 2 IAS/IFRS)
Admission documents	Admission documents	Prospectus
Business plan/QMAT	No	Yes
Post-admission		
Quarterly report	No	Yes
Investor relation manager	No	Yes

Source: Baffi Carefin Università Bocconi

The Competitiveness Decree poses new regulatory provisions for SMEs approaching the capital market in order to go public. In particular the legislation simplifies the TUF (Testo Unico Finanza) with respect to many points. First, the decree introduces a new definition of SMEs with listed shares as those with maximum revenues of €300 million or a market capitalization below €500 million according to their most recent financial statements. The Decree specifically allows for a more flexible approach regarding:

1. Mandatory takeover bids: SMEs can now introduce a threshold between 25% and 40% (different from the general 30%), thus giving the company the option of choosing a low threshold (mitigating the risk of losing control) or a high one (facilitating the presence of new shareholders).
2. Multiple voting right shares: SMEs can issue this class of shares with a maximum of 2 votes per share provided that it is held for at least 2 years. This provision is an attempt to increase the number of companies approaching the listing procedure while diminishing the risk of losing control. The latter case has long been a deterrent for the listing of SMEs.

Although important steps forward have been taken with initiatives for SMEs, the central problem remains the lack of investors in stocks. On the equity side in particular, four key points still need to be addressed:

1. Fund of funds for the AIM should be fostered, financed by CDP in order to attract a stable class of investors. More in detail, it should have a minimum investment horizon of 5 years, optimal resources for €500 million and give the resources to at least 10 operators (€50 million each).
2. Fiscal incentives for individual schemes: these incentives would be extremely efficient to channel funds into the real economy in a coherent way. A positive example can be found in the UK, with Individual Saving Accounts.
3. New investors specialized in small caps should be attracted: fiscal incentives for these investors should be supported, in keeping with the positive UK experience.
4. A new investment policy for pension funds should also be taken into account. Pension funds represent potential crucial investors in equity and debt securities, given their massive financial resources.

TABLE A
Pre and post admission
obligation on the AIM
and MTA segment

Continuing on the equity side, it is worth mentioning Decree n. 179/2012 which introduced a specific discipline for online equity crowdfunding in order to back innovative start-ups. The main purposes of this discipline are to channel investors' financial resources into socioeconomic projects, incentivizing innovation and helping the weak private equity sector in Italy.

Debt Side

On the debt side, it is worth mentioning that the Competitiveness Decree also introduces measures concerning the options available to SMEs in the credit market. In particular (i) direct funding from insurance and securitisation companies to SMEs; (ii) amendment to the provisions governing debt securities (i.e. minibonds) issued by SMEs, according to which no withholding tax (26%) shall be paid by investors when those securities are traded on regulated markets or MTF, provided they are held by one or more qualified investors.

A part from the very recent regulatory development highlighted above, in general the legislative framework refers to the Law Decree n. 83/2012 converted with Law 134/2012 and then amended ("Decreto Sviluppo Bis"), which thoroughly describes the type of instruments available to SMEs, specifically, short and long term bonds and commercial papers and their quantitative restriction at issue. The Decree refers to small enterprises (less than 50 employees and less than €10 million. in annual turnover) and medium enterprises (less than 250 employees and less than €50 million. in annual turnover). The main point refers to the fiscal regime, which waives withholding taxes on interest for the issuer (as above), and also includes some provisions on the deductibility of interest and cost of issuances.

Another important step forward is the so-called "Decreto Destinazione Italia" n.145/2013 which has stipulated a number of provisions in order to foster investments in SMEs. Specifically, (i) corporate bonds can now be secured by a special type of security (the so- called "Privilegio Speciale"), which covers a broader array of assets such as plant and machinery, raw materials and receivables; (ii) insurance companies can use these bonds as technical reserves while pension funds can invest in minibonds even if not traded on an MTF; (iii) additional tax incentives for minibonds are put in place.

Summary

Great effort has been expended on the side of incentives for issuers but not for the investors. As a consequence,

- So far only a few debit funds have been successfully closed, out of those announced.
- Government-driven resources have not yet been allocated.
- No fiscal incentives for investors have been hypothesized to compensate for the relative illiquidity of minibonds.

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As the ongoing contraction of bank credit challenges the funding of corporate investment, capital markets gain a new centrality into the current political debate on how to renew Italian corporate growth and relaunch the country. In this context, the BAFFI CAREFIN Center for Applied Research on International Markets, Banking, Finance and Regulation and Equita SIM renovate their joint effort to analyze the major characteristics of the Italian financial market and to make a concrete contribution to the debate on this vital issue for the development of the country, by searching incisive solutions and attentively and rigorously monitoring their implementation and evolution. This second joint project, “Capital Markets and Investors in Italian Securities: Is there a communication breakdown?”, in particular, analyzes the attitude of investors towards equity and debt securities issued by Italian companies in an effort to assess their potential role in financing Italian companies.