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 third joint project carried out a benchmarking exercise involving the UK and Italian contexts. The objective was not to identify what is good (or better) and what is not. We have compared the two countries to show how a different political economy view can impact the functioning of financial markets, the behaviour of investors, and the financial policies of corporations. Data reported in the paper clearly indicate a convergence of the two financial systems and many steps have been already implemented in Italy and many are still in the policymaking agenda. The benchmarking exercise of this paper might indicate further ideas to accelerate the reform of the Italian financial system.

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Benchmarking the UK Market: A way to create an efficient and effective capital market in Italy?*

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In collaboration with

EQUITA SIM SpA

*Please note that the views expressed herein are those of the authors only and should not be taken as representative of their employers or of any other person

Benchmarking the UK Market: A way to create an efficient and effective capital market in Italy?

Preface

by EQUITA SIM

During the first few years of the financial crisis, Italian commentators, when comparing Italy to the UK, always highlighted the inherent weakness of the UK economy, its over reliance on finance, its depleted manufacturing industry as well as the damages to the real economy caused by its complex financial system and products. Italy, commentators maintained, would emerge from the crisis much better than the UK thanks to our strong manufacturing base and the fact that our financial system was based on solid, traditional banks.

History clearly proved those commentators wrong: the UK has been out of the recession for a few years and its economy is consistently growing at a faster pace than the Italian one. Moreover, whilst in the UK financial crises have been largely limited to a few institutions such as Royal Bank of Scotland and Northern Rock, the weakness of Italy's banking system and strong need for its reform have become clear and continue to impact negatively our economy. And finally, whilst the debt and equity capital markets in the UK have once again proved to be a formidable source of funding for companies as well as a great means for British savers to diversify their financial assets, Italian capital markets have continued to struggle, with a decreasing number of brokers, few successful Initial Public Offerings and a very limited number of domestic investors, forcing companies and savers to rely mostly on the banking system for their funding and investments, with a disproportionate share of Italian wealth invested in underperforming and illiquid real estate assets.

It is important to note, that the strength of UK's capital markets is primarily the direct consequence of a clear focus by all of the UK governments over the years, regardless of their political colour, based on the assumption that strong capital markets would be a key factor to ensure efficient funding for companies, asset diversification for citizens as well as a great opportunity for job creation. The UK institutions clearly showed their determination in protecting their capital markets when they executed a swift reform of their financial regulatory bodies after the first few years of the financial crisis and when they fought hard to prevent the Tobin tax to affect their equity markets, unlike Italy which is one of only two countries in Europe to impose such tax despite its marginal contribution to tax revenues and negative impact in the context of global competition for capital.

During the celebration for the first 20 years of the Alternative Investment Market (AIM), the UK's Business Secretary, representing the Government, gave a speech including these words: "Over the past 20 years, well over £90 billion has been raised by companies listed on the AIM. That's £90 billion invested in the future of exciting, ambitious businesses. £90 billion that has allowed innovative, growing companies to reach their true potential. And most importantly, £90 billion that has helped create hundreds of thousands of jobs for hard-working people right across the UK. When the AIM does well, when entrepreneurs do well, the whole country does well. And I'm proud to say that this government has a long record of helping to make that happen."

These few words clearly show what is at the heart of the successful UK financial industry: a strong political vision that efficient capital markets are good for the country, its companies and citizens.

Within this context, we welcome the opportunity to continue Equita's long-standing cooperation with Bocconi University aimed at analysing the capital markets for Italian companies and proposing initiatives to improve them, also in the light of successful examples taken from the most developed ones in Europe. After analysing in the past two years the investment banking industry in Italy and our investor base, this year's focus, the comparison between the Italian and UK capital markets and the lessons we can learn from the most successful example in Europe, helps us identify actionable solutions that would enable our markets to become more efficient and help our companies to prosper.

We are very pleased that the recent Italian governments have improved and simplified access to the capital markets for Italian companies, with a number of regulatory initiatives during the last few years aimed at creating a real funding alternative for companies other than the traditional banking system. But a clear organic vision of the industry and a coordinated effort for an industrial policy regarding the asset management and investment banking industries have yet to become a priority for Italian institutions.
The UK example, where such vision has been paramount for decades, indicates some clear actions to be taken in Italy:

- *Promote healthy investment banking and asset management industries, with strong independent players;*
- *Provide incentives, including tax breaks, to encourage Italian individuals to invest in debt and equity securities (similar to Individual Savings Accounts in UK);*
- *Dedicate specific funds, partly funded by public entities, to the investment in Italian small caps (similar to Venture Capital Trusts in the UK);*
- *Further develop privately-managed pension systems based on efficient and diversified pension funds;*
- *Remove to the highest possible level the conflicts of interest of lending banks when dealing with investors or corporate finance clients;*
- *Increase high-quality research on companies accessing the capital markets, if necessary by making it mandatory for listed companies to use "corporate brokers", helping them in understanding investors and better communicating with them;*
- *Simplify listing rules as much as possible, obviously within the boundaries of European rules and best practices, and modify the approach of Italian authorities so as to avoid the current anomaly whereby Royal Mail was privatised in the UK with a 450 pages prospectus whereas for Poste Italiane almost 1000 pages were necessary, without anybody with good common sense understanding why.*

We wholeheartedly encourage our policy makers and regulators to start developing a coordinated legal and tax framework and promoting a real industrial policy for the Italian capital markets and the asset management sector. And we thank once again Bocconi University for this high quality and extremely helpful analysis and the potential concrete initiatives arising from it.

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Stefano Gatti is Director of the Full Time MBA at SDA Bocconi School of Management. He has been the Director of the B.Sc. of Economics and Finance at Bocconi University, where he has also acted as Director of the International Teachers' Programme. His main areas of research are corporate finance and investment banking. He has authored papers in these areas including publications 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 published a variety of texts on banking and finance, and has acted as a consultant to several financial and non-financial institutions, as well as for the Italian Ministry of the Economy, the Financial Stability Board, the InterAmerican Development Bank and the OECD/Group of G20. He is financial advisor of the Pension Fund of Health Care Professions and is a member of the Board of Directors and Board of Auditors of Italian industrial and financial corporations.

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Gimede Gigante, PhD, is contract Professor of Financial Markets and Institutions at Bocconi University. He has held visiting positions at the Finance Department of Columbia Business School, and at the Salomon Brothers Center (Stern School of Business, NYU). Chartered Accountant and professional auditor, he earned a business degree from Bocconi University and a PhD in Banking & Finance from the University of Rome. He holds the ITP qualification (International Teachers' Program) from SDA Bocconi School of Management.

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Introduction

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 have realized 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 displayed financial weakness during the crisis due to the historical and almost exclusive reliance on conventional bank credit.

However, the transition by Italian companies to a more balanced funding structure is still far from complete. On the equity side, companies and banks need capital to rebalance their capital structure by increasing their capitalization. On the debt side, however, companies must 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 recent fiscal and legislative efforts, sharply contrasts with the central role these markets should take.

On the debt side, the inadequacy of the domestic capital market has favoured the growth of foreign markets which are dominated by large foreign investors. As a consequence, access to these markets is mainly 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 volume of issuance by European companies on major private placement markets. The dismal contribution of Italian companies is restricted to the well-developed U.S. market. No Italian company has accessed the more mature Corporate Schuldschein market, while only in 2015 CNL Magnetto was the first Italian company to raise funds on the nascent European Private Placement market, approximately for €100 million.

TABLE 1
The breakdown of the volume of issuance by European companies on major private placement markets, 2014

Market	European (€ bn.)	Italian %	UK %
US Private Placement	12.9	3%	52%
Corporate Schuldschein	11.0	-	n.a.
European Private Placements*	7.0	-	n.a.
Total	**30.9**	-	-

Source: S&P[1]

** European Private Placements includes listed and unlisted deals under the Euro PP charter as well as private placements from European issuers outside of the Euro PP market.*

On the equity side, the Italian stock market is underdeveloped as compared to its British counterpart both with regard to size and performance. In absolute terms, slightly less than 200 non-financial firms are currently listed on Borsa Italiana, while the London Stock Exchange counts more than 650 non-financial firms. Moreover, according to the latest estimates reported by the World Bank, the capitalization of Italian listed companies corresponds to just 29.9% of domestic GDP, while in the

[1] Standard & Poor's (2015), Banking Disintermediation in Europe – A slow growing trend

UK this figure is 115.2%. The aggregate amount of investment flows on UK markets since 2006, which amounts to around €491 billion on 1631 deals, is approximately five times that in Italy, slightly less than €110 billion on 307 deals. Not surprisingly, the median issue size is comparatively larger on the Italian markets, consistent with the fact that UK markets are more accessible and therefore providing a more efficient source of corporate financing even for smaller companies.

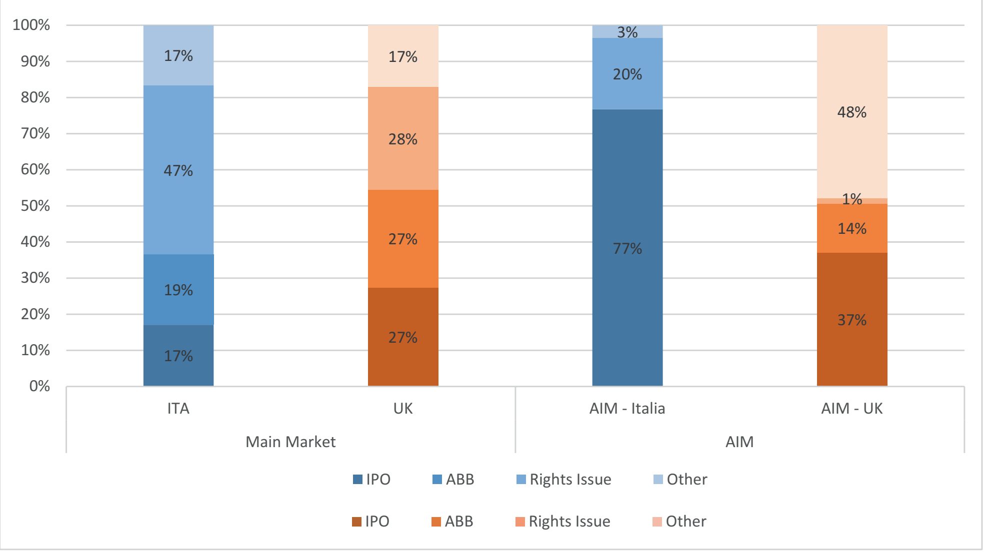
TABLE 2
Equity markets investment flows in Italy and the UK, 2006-2015Q3: issue size

Market	Average (€ million)	Median (€ million)	St. Dev. (€ million)	Min (€ million)	Max (€ million)
Italy Borsa Italiana	335.23	130.00	730.49	0.59	6,432.07
UK London Stock Exchange	301.41	100.50	881.03	0.02	15,389.23
AIM - Italy	11.95	5.35	20.22	0.23	139.26
AIM - UK	19.83	4.57	51.83	0.01	1,402.44

Source: authors' elaboration of Dealogic data

This argument is further confirmed by the sectorial breakdown of the investment flow in the main markets. While in Italy the largest contribution comes from banks, with more than 40% of total investment flow, in the UK, industrial companies are predominant, with a relative share in excess of 51%. In particular, taking a closer look at the structure of the markets, while IPOs, ABBs and rights issues contribute almost evenly to total investment flow in the UK, rights issues are instead more abundant in Italy, as shown in *Figure 1*. In this respect, the Italian stock market seems to be less appealing for not-yet-listed firms. First, the Italian production system is made up of relatively smaller companies that do not reach the critical mass necessary to successfully access capital markets; consequently these businesses rely almost exclusively on bank financing. In addition, Italian firms are also more reluctant to allow outside investments and acquiesce to market discipline. Investment flow in the Italian equity market is therefore driven mostly by already-listed firms.

FIGURE 1
Breakdown of investment flows in Italy and UK, 2006-2015Q3



Source: authors' elaboration of Dealogic data.' Other' includes inter alia: convertible debt which is a substantial share of the investment flow on the main market in Italy, and cash placings (i.e. direct issue of securities to one or more selected investors), which account for a sizable share of the investment flow on the AIM – UK.

Indeed, the last few years have seen relatively fewer IPOs, more frequent withdrawals of planned IPOs and increasing delistings in Italy. Since 2009, the number of companies listed in Italy has dropped on average by 10 each year. In addition, the rate of withdrawn IPOs (over all announced IPOs since 2006) has reached 40.7%, well above the corresponding rate in the UK, as shown in *Table 3*.

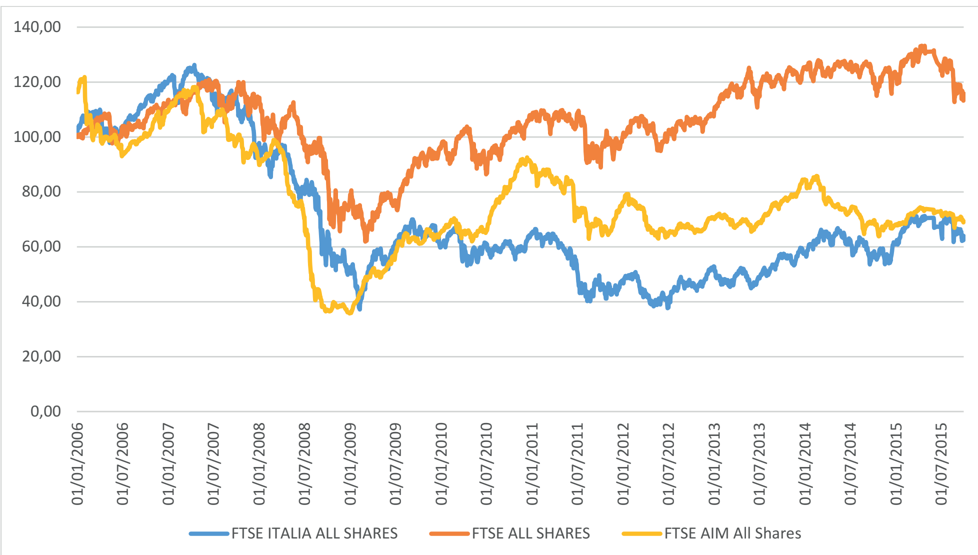
TABLE 3
The volume of IPOs and the frequency of withdrawals on UK and Italian main markets 2006-2015Q3

Market	**Completed**		**Withdrawn**	
	#IPOs	**Amount**	**#IPOs**	**% over all announced**
Borsa Italiana	89	18.7	33	40.7%
London Stock Exchange	283	134.5	87	30.3%
Total	**372**	**153.2**	**120**	**32.6%**

Source: authors' elaboration of Dealogic data

Also in terms of performance, the Italian market has been disappointing. While the UK stock market has by now made a complete turnaround, surpassing its pre-crisis highs recorded in early 2007, the Italian market is still lagging behind, as shown in *Figure 2*. On top of that, the latter is structurally more volatile than the UK market. Indeed, the standard deviation of daily returns between January 2006 and September 2015 was 1.60% in Italy, while over the same period in the UK daily volatility was just 0.86% in the main market and 1.22% in the AIM.

FIGURE 2
Stock markets performance in Italy and the UK, 2006-2015Q3



Source: Bloomberg

Further looking in more details at the recent developments on the AIMs in the two countries, the impression is that in Italy there is a disconnection between companies' financing needs and capital markets. Indeed, according to the most recent statistics released by the London Stock Exchange, 1056 companies are listed on the UK-AIM for a total market capitalization in excess of €63 billion. In contrast, only 50 Italian companies have accessed their national AIM since its inception, and their aggregate market capitalization is just above €2 billion. *Table 4* summarizes IPOs on AIMs in Italy and the UK since 2006.

TABLE 4
The volume of IPOs on alternative investment markets in Italy and the UK 2006-2015Q3:

Market	**Completed**	
	#IPOs	**Amount (€ billion)**
AIM - Italy	50	0.5
AIM - UK	751	30.6
Total	**801**	**31.1**

Source: authors' elaboration of Dealogic data

In light of the above arguments, and given the importance of bringing together companies and capital markets, in this paper we disentangle the reasons for the poor development of Italian capital markets and their disconnection from companies. We do so by offering a comparative analysis with the UK capital markets, with a special focus on equity markets and IPOs.

Indeed, while the UK and Italy share a similar regulatory framework, as regulated by European laws, capital markets in Italy are comparatively underdeveloped. Is this gap due to demand or supply factors? Or is it the consequence of the different structure of the markets and the procedures put in place to access them, as conceived by national authorities? Ultimately we are convinced that addressing these questions is of crucial importance in particular in terms of a policymaker agenda, and that benchmarking Italy with the UK can be a viable way to foster the efficiency and the effectiveness of capital markets in Italy.

The remainder of this paper is organized as follows: In the next section we provide an overview of how companies source financing in Italy and the UK, looking in particular at their external financing needs and their demand for capital. More specifically, we compare the characteristics and the capital structures of firms accessing capital markets in Italy and the UK in an effort to highlight the structural differences across the two markets. Then, we offer empirical evidence on investor attitudes towards equity securities in Italy and the UK based on a supply-side analysis of equity capital markets by comparing the ownership structure of publicly-listed companies in Italy and the UK and how it has evolved. In this regard, we pay particular attention to variations in the breakdown of overall supply by different types of investors and their geographical origin. Then, we shore up this evidence with a comparative analysis of recent IPOs in Italy and the UK to shed light on procedural differences and link market development to post-IPO performances. Finally, in the last section we draw our main conclusions and offer our recommendations.

The Demand for Capital by Companies

In this section, we compare the demand for capital by Italian and UK companies in an attempt to identify structural differences that could justify the substantial gaps in both efficiency and effectiveness across the two markets. In particular, we address the following questions: Is the comparative underdevelopment of the Italian capital markets due to limited demand from companies? How do companies that access capital markets in the UK compare to those in Italy? Are Italian companies unable to tap into these pools of capital?

In the last few years, the landscape of corporate financing has undergone substantial changes at the European level:

- First, the experience of the financial crisis gave banks and their regulators a better understanding of the risks posed by excessive leverage. This led to retrenchment by banks – a reduced supply of credit through the traditional banking channel, which in turn prompted corporates to diversify their funding strategies. Faced with the stark evidence of the risks of relying on one funding source, businesses increased their demand for non-bank finance;
- Second, this diversification has been supported by structural change flowing from several sources. For example, technological innovation has facilitated new forms of intermediation such as peer-to-peer lending; the public sector has played a role too, by encouraging direct non-bank lending;
- Third, the monetary policy adopted by central banks has contributed to a decline in long-term government bond yields, prompting investors to seek yield elsewhere, including the corporate bond market.

Indeed, post-crisis deleveraging has been accompanied, on the debt side, by funding 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 resulting from the contraction in bank lending. As a consequence, in the last few years, a rise in bond issuance has been recorded at the European level. In particular, *Figure 3* compares the recourse to bond issuance and bank loans by European companies from 2006 up to the second quarter of 2015. According to the most recent estimates, new bond issuance accounts for 39% of total new debt – much higher than the 25% average in the pre-crisis period.

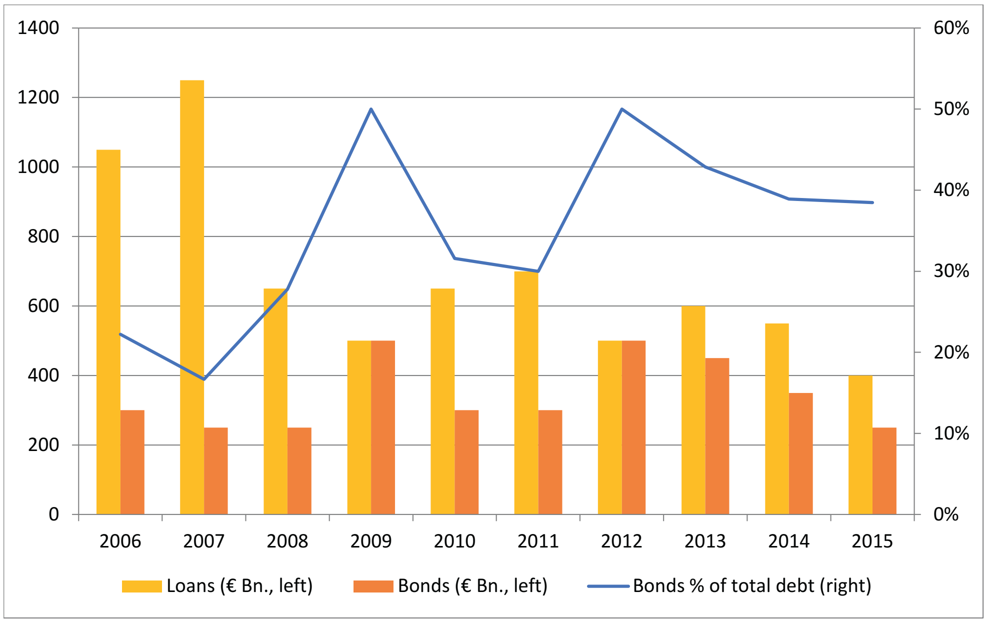


FIGURE 3
Bond Issuance Share of Corporate Funding in Europe, 2006-2015Q2

Source: Dealogic, Fitch

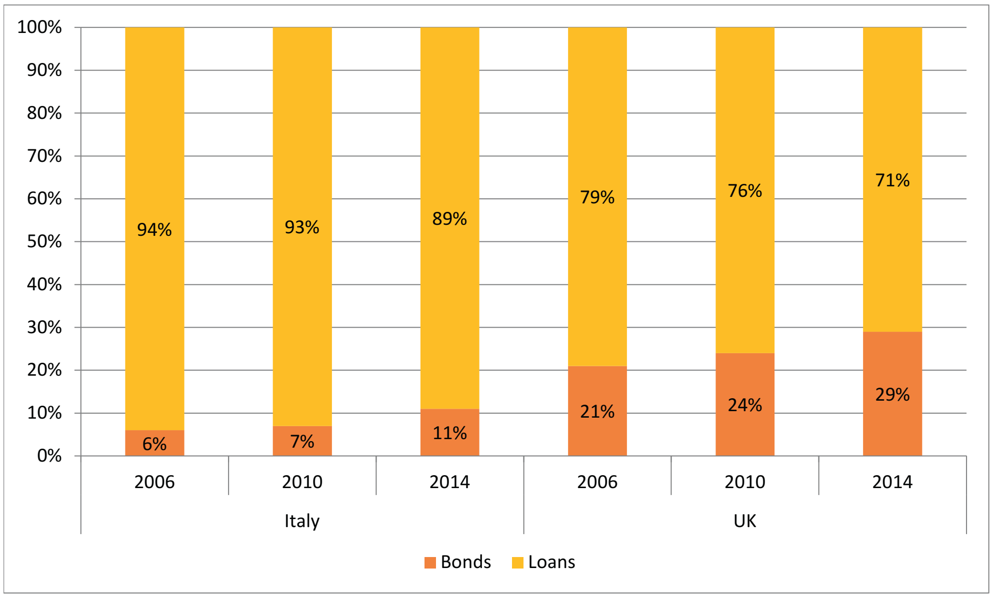
While public and private financing routes are generally developing as an alternative to bank financing, the degree of contraction in bank lending and disintermediation varies across countries.

In the UK,[2] average net lending by banks to non-financial domestic corporates, between 2000 and 2007, was £38 billion per year, while since 2009, net lending has decreased by £17 billion per year. In response, larger firms have increased bond issuance, particularly in international bond markets. Annual net issuance by private non-financial UK corporates, which averaged £13 billion between 2000 and 2007, has been on average £30 billion since 2009. However, it is not just total issuance that is on the rise. Bond markets have become available for a larger number of companies. Between 2000 and 2007, there were on average 6 first-time non-financial UK corporate bond issuers per year. Since 2009, there have been 26 per year, with large and medium-sized firms making greater use of private placement markets such as the well-established US private placement and German Schuldschein markets, as well as nascent ones such as the French Euro Private Placement market. Consistently, the size barrier to corporate bond issuance is now lower. Indeed, according to the estimates of the Bank of England, on the basis of data collected by Dealogic, the size of the median corporate bond issuer has decreased by half since the crisis.

[2] Speech given by Chris Salmon, Executive Director, Markets, Bank of England at the Association of corporate Treasurers Corporate Funding Conference, London 28 October 2015

However, the funding gap has been even wider in Italy than in the UK. According to the Bank of Italy, bank loans to non-financial corporates in Italy have dropped by €84 billion, just in the three-year period between 2012 and 2014. This fall back was only partially counterbalanced by an increase in bond financing. Indeed, *Figure 4* shows that the proportion of bonds to total debt funding almost doubled in Italy compared to 2006, from 6% to 11%. However, the increase in net debt issues, which accounts for approximately €41 billion in the three-year period between 2012 and 2014, was not enough to fully offset the shrinkage in bank lending. Nevertheless, according to CONSOB, 40% of gross bond issues by Italian companies are characterized by low credit ratings, while the European average is close to 21%. This may suggest that bond markets have become available for a larger number of companies, as yield-starved investors are looking more favourably on more risky asset classes. This is particularly evident by observing firms that issue Minibonds. Initially, this instrument was used mainly by medium-sized firms, but the most recent issues may be indicative of a downward trend in the size of the issuers. Among all the issues in 2015, most fall short of €50 million; indeed the average size is €8 million. The comparatively poor quality of the issuers in Italy, however, could per se be detrimental for the development of bond markets by shrinking the pool of investors potentially interested in this asset class, as poor quality issuers may crowd out good quality ones. Indeed, low ratings of Italian issuers may well reflect structural financing patterns such as more leveraged and undercapitalized capital structures. Yet this situation also reveals the attempt by firms that have been cut out from bank lending to substitute loans with disintermediated debt instruments.

FIGURE 4
Corporate funding in 2015: Italy vs. UK

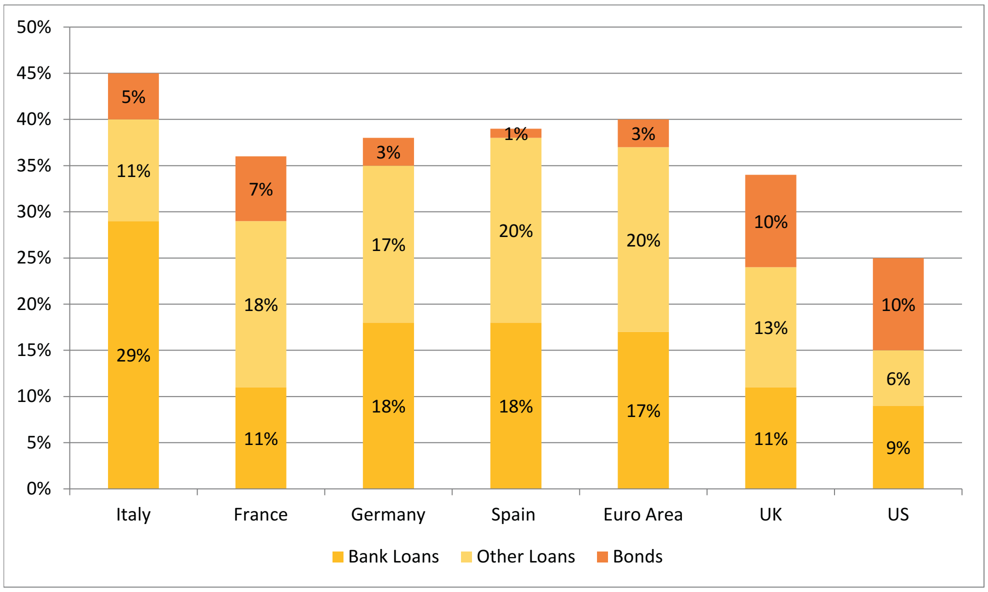


Source: S&P[3]

In fact, Italy's bank-centrism in corporate funding is more severe than in the UK, the US and all other major European economies; this condition also affects corporate capital structure. *Figure 5* compares the level of leverage across different countries in 2014 and shows how loans and bonds contribute to the composition of financial debt. Italy's corporate funding model is not only the most bank-centric, with bank loans accounting for almost 65% of total debt funding, but it is also the most leveraged, reflecting the chronic undercapitalization of Italian firms compared to their international competitors.

[3] Standard & Poor's (2015), Banking Disintermediation in Europe – A slow growing trend

FIGURE 5
Leverage (left) and composition of financial debt in 2014



Source: Bank of Italy, ECB, Federal Reserve System – Board of Governors.

If leverage is the preeminent source of capital in the Italian corporate funding model compared to other countries, equity markets must play a minor role in the financing of firms. Furthermore, the bank-centrism and undercapitalization of Italian companies should be even more pronounced for small- and medium-sized enterprises. In this regard, *Table 5* summarizes the typical issuers in the equity capital markets in the UK and Italy by comparing the dimensional characteristics of companies across markets. Those listed on the UK's main market are considerably larger than their Italian counterparts, both in terms of annual sales and number of employees. However, the median sales of firms listed on the AIM is lower in the UK than in Italy, consistent with the notion that the latter is not yet as effective and efficient as the former in providing corporate funding to small-and-medium size enterprises. Finally, the range of companies with access to the equity capital markets in the UK is broader than in Italy. This potentially fosters better diversification across alternative sources of funds in the UK, which represents a strong driver of stable growth.

TABLE 5
Dimensional characteristics of issuers in the equity capital markets in the UK and Italy, 2014

Market	**Sales**		**Employees**	
	Average (€ million)	**Median (€ million)**	**Average**	**Median**
Italy Borsa Italiana	3,116	252	7,743	992
UK London Stock Exchange	6,310	895	18,190	3,890
AIM - Italy	55	16	173	54
AIM - UK	59	10	479	88

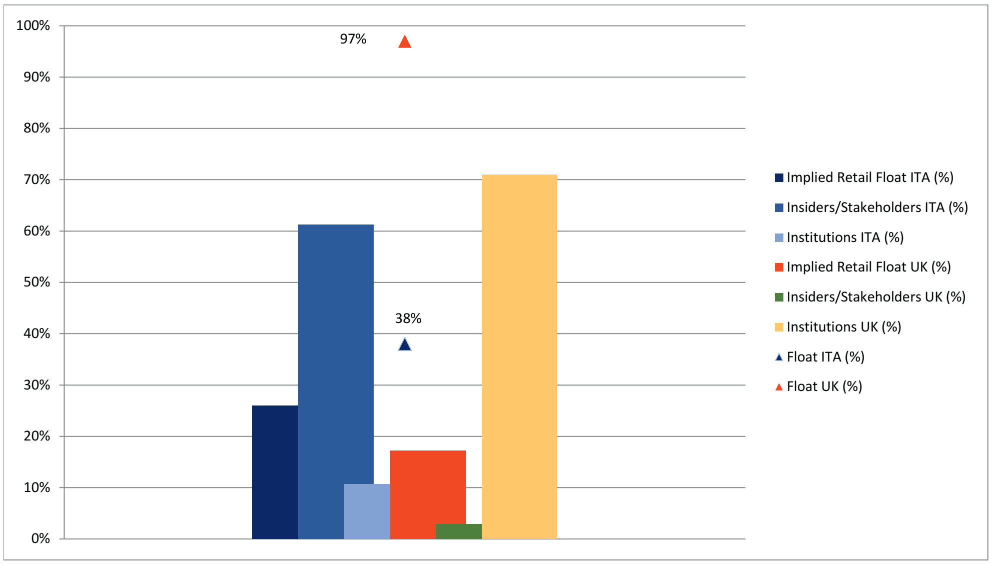
Source: Mediobanca, Bloomberg, FTSE

The Supply of Capital by Investors

In this section, we provide an indirect assessment of the supply of equity capital by studying the ownership structure of publicly - listed companies in Italy and the UK and how this structure has evolved.

In *Figure 6*, we show two sets of data. First, triangles indicate the percentage of share free float in the all-share markets in the UK and Italy. Second, columns indicate the percentage of float owned by each category of investor.

FIGURE 6
Breakdown by investors: October 2015 (All share market)



Source: authors' elaboration of Dealogic data

The graph shows deep differences between the two markets. In particular, in the UK float is 97%, while in Italy this figure is rising slightly from 2011, but is still less than 40%. Insiders/stakeholders are dominant in the Italian market (accounting for a share larger than 60%), while in UK their position is limited to a mere 5%. Institutional investors hold the most of the float in the UK (around 70%), while in Italy their share is around 10%. Implied retail float in Italy is around 25%, compared with just over 15% in the UK in October 2015.

Table 6 and *Table 7* show instead the geographic origin of investors active on the all-share equity market, in Italy and in the UK. The former is mainly dominated by foreign investors and domestic investors hold a portion of Italian shares of around 20%. The most important foreign investors here are from the US, the UK, France and Switzerland. On the other hand, the principal players on the UK all-share market are domestic investors, with more than 50% of shares. The second most important investors in the UK market are from the US with a share that has risen from 25% in 2011 to 31% in 2015. Other countries taken together make up around 15% of market share. Moreover, investors from the UK hold more than 50% of shares in their domestic market plus 10% of float in the Italian market. On the contrary, Italian investors hold a limited portion of float in their domestic market and have a very small share of the UK market (around 1%).

TABLE 6
Breakdown of investors in Italy by geographic origin (All-share market)[4]

Securities	2011 Securitiesa	2012 Funds Sharesb	2013	2014 Management	Oct-2015
United States	28.9%	27.7%	27.9%	26.0%	25.7%
Italy	19.7%	21.5%	21.0%	20.1%	18.7%
United Kingdom	15.3%	15.8%	15.8%	17.8%	17.7%
France	9.0%	9.4%	8.5%	8.6%	9.3%
Switzerland	4.7%	4.5%	4.9%	5.7%	6.4%
Norway	4.6%	4.3%	4.7%	4.4%	4.3%
Luxembourg	1.5%	1.5%	2.6%	3.4%	2.9%
Germany	3.7%	3.6%	3.7%	3.8%	3.8%
Belgium	2.0%	2.1%	1.8%	1.9%	2.4%
Netherlands	1.9%	1.8%	1.4%	1.6%	1.5%
Canada	1.3%	1.5%	1.5%	1.4%	1.4%
Spain	1.5%	1.7%	1.5%	1.4%	1.6%
Denmark	0.7%	0.5%	0.8%	1.0%	1.0%
Ireland	1.1%	1.0%	0.8%	0.8%	1.0%
Sweden	1.6%	1.1%	0.9%	0.4%	0.4%
Other	2.3%	2.1%	2.1%	1.9%	1.8%

Source: authors' elaboration of Dealogic data

TABLE 7
Breakdown of investors in UK geographic origin (All-share market)

Securities	2011 Securitiesa	2012 Funds Sharesb	2013	2014 Management	Oct-2015
United States	25.1%	26.9%	28.3%	29.7%	30.8%
Italy	0.2%	0.1%	0.0%	0.0%	0.1%
United Kingdom	60.2%	58.3%	56.9%	54.4%	53.8%
France	0.8%	0.8%	0.8%	1.0%	1.1%
Switzerland	1.0%	1.0%	1.1%	0.8%	1.2%
Norway	3.5%	3.9%	3.9%	4.1%	3.9%
Luxembourg	0.1%	0.2%	0.0%	0.1%	0.3%
Germany	0.7%	0.8%	0.8%	0.9%	1.0%
Belgium	0.1%	0.0%	0.0%	0.1%	0.1%
Netherlands	1.5%	1.0%	1.0%	1.6%	1.0%
Canada	1.1%	0.9%	0.8%	1.0%	1.0%
Denmark	0.1%	0.1%	0.3%	0.2%	0.1%
Ireland	0.1%	0.2%	0.1%	0.1%	–
Sweden	0.3%	0.5%	0.6%	0.5%	0.5%
Other	4.9%	5.1%	5.3%	5.4%	5.1%

Source: authors' elaboration of Dealogic data

[4] The category "Other" includes countries with a share lower than 2%

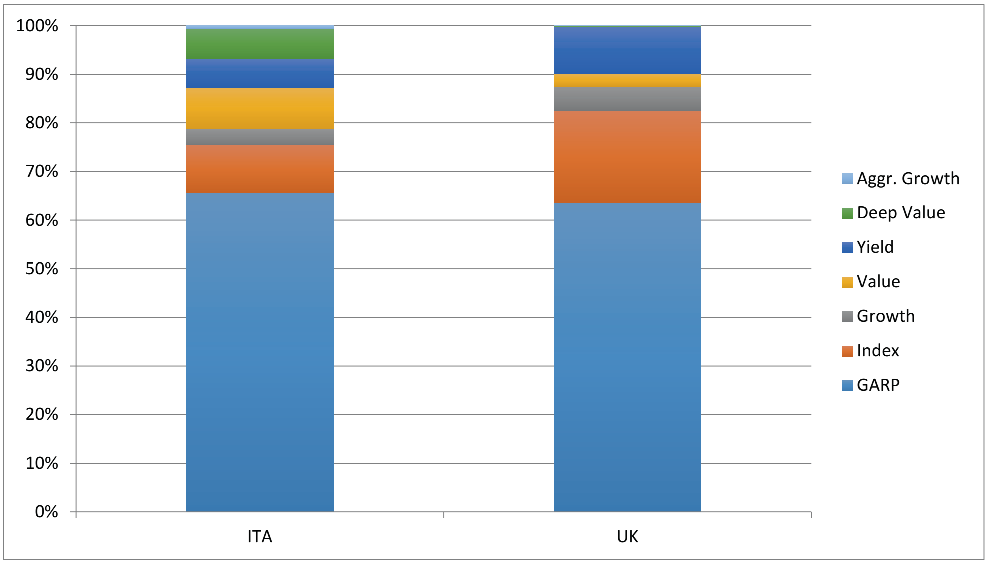
One way for us to indirectly test the reasons behind the evidence detailed in the previous paragraph is to look at the different investment styles that best characterise investor activity in the UK compared to the Italian financial markets.

In *Figure 7* we consider a breakdown of the activities carried out by investors based on their investment style in the UK and Italy as of October 2015[5]. As for reference parameters, we refer to seven distinct categories:

- **Yield**: The only portfolio characteristic that we screen for this style is Dividend Yield. Any institution that holds more than 90% of their assets in stocks that yield more than the broad market are classified as managing with a Yield style;
- **Deep Value**: The primary screen for this style is the Price-to-Book (P/B) ratio. Candidates for Deep Value are institutions that have not been classified with a Yield style and which hold more than 90% of their assets in stocks with below-market P/B ratios. These stocks are then screened by their Price-to-Earnings (P/E) ratios; only the portfolios that hold more than 90% of their assets in stocks with below-market P/E ratios are classified as Deep Value;
- **Value**: The primary screen for this style is the P/B ratio. Institutions are candidates for Value if they have not been classified with a Yield or Deep Value style, and they hold more than 70% of their assets in stocks with below-market P/B ratios. These stocks are then screened by their P/E ratios; only the portfolios that hold more than 70% of their assets in stocks with below-market P/E ratios are classified with a Value style;
- **GARP**: All portfolios that do not fall into any of the other six categories (including the Index category) are assigned a GARP classification (Growth at a Reasonable Price), based on internal research by investors. GARP investors generally hold equities trading at a discount to market or sector/industry valuations. These companies are expected to grow at a higher rate than the market or sector/industry average;
- **Aggressive Growth**: The primary screen for this style is the one-year revenue growth rate. Institutions that hold more than 75% of their assets in stocks with above-market revenue growth are candidates for Aggressive Growth. These stocks are then screened by P/E ratios, and only the portfolios that hold more than 50% of their assets in stocks with above-market P/E ratios are classified as Aggressive Growth;
- **Growth**: The primary screen for this style is the one-year revenue growth rate. Candidates for Growth include institutions that have not been classified with an Aggressive Growth style, and which hold more than 40% of their assets in stocks with above-market revenue growth. These stocks are then screened by P/E ratios; only the portfolios that hold more than 40% of their assets in stocks with above-market P/E ratios are classified with a Growth style;
- **Index**: Index style for an institutional portfolio is attributed manually, based on information from fund managers or the prospectus, factsheets or annual/semi-annual audited reports and accounts for each fund.

[5] October 2015 was taken as the latest available data that was in line with historical breakdown by investment style

FIGURE 7
Breakdown by investment style (All-share market) – Oct 2015



Source: authors' elaboration of Dealogic data

In both markets, the most common investment style is GARP, accounting for more than 60% in both markets. One of the highlights from this chart is the relatively greater importance of the Value/Deep Value investment styles for the Italian financial market, when compared to the UK. The combined share of these two styles makes up 16.4% of investments in Italy versus only 2.9% in the UK. This suggests that investors are turning to the Italian market primarily when looking for mispriced assets, or in layman's terms, to buy on sale. This is broadly consistent with the more widespread use of the Index investment style in the UK, relative to Italy. Indeed, the Index investment strategy is the best proxy for active management, among the investment styles listed above. The role it plays in the UK (18.9%) is far more substantial than in the Italian market (9.8%). This only serves to confirm that investors think they can find more interesting investment opportunities in the UK market. In fact, they are actively trying to take advantage of these opportunities through more rigorous strategies for both allocating financial resources across asset classes/sectors and selecting financial assets.

Figures 8 and *9* report a breakdown by investment type as of October 2015. As we can clearly see, in the UK the financial business carried out by professional investors plays a far more prominent role than in Italy. Particularly, we can note the combined importance of both Investment Advisers and Mutual Fund Managers.

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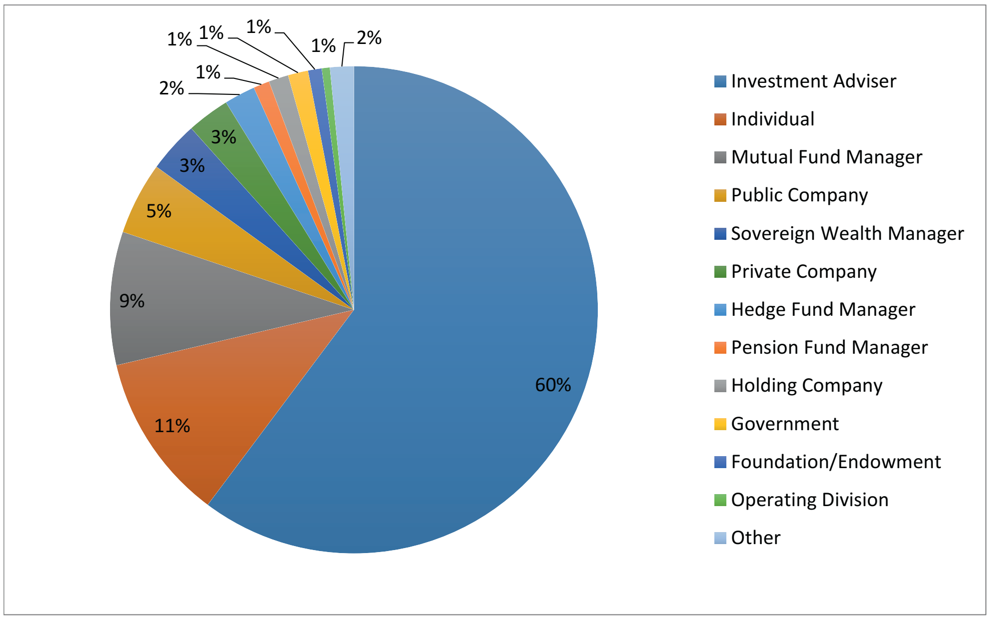
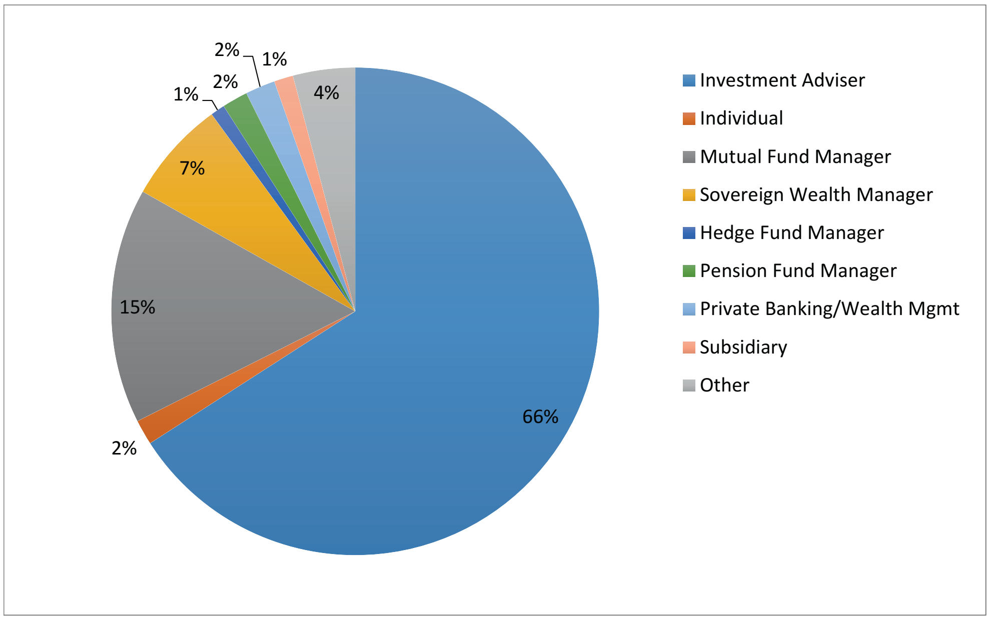
FIGURE 8
Breakdown by investor type[6] (ITA all-share) – Oct 2015



Source: authors' elaboration of Dealogic data

FIGURE 9
Breakdown by investor type[7] (UK all-share) – Oct 2015



Source: authors' elaboration of Dealogic data

In the UK, the same share represented by Investment Advisors plus Mutual Fund Managers stands at 81%, which compares with a lower 69% for Italy. This is also consistent with the percentage of investments attributable to Individuals: 9% in Italy versus 2% in the UK.

[6] "Other" includes all categories that account for less than 1%.

[7] October 2015 was taken as the latest available data that was in line with historical breakdown by investment style

The Access to Capital Markets and Their Structure

Is the comparative underdevelopment of the Italian capital markets simply due to cultural differences across Italy and the UK? Or is it instead the consequence of some regulatory and fiscal differences that impact the demand and supply of capital on the markets in the two countries? And more specifically, how do these differences affect the access to the markets and their structure? In this section, first we provide an overview of the relevant regulatory and fiscal framework. Then we furnish a comparative analysis of recent IPOs in Italy and the UK, to link market development to post-IPO performances and to shed light on some procedural dissimilarities that can shape market structures.

The Role of Regulation and Taxes in the Development of Capital Markets

The picture that emerges from our analysis of the demand for capital by firms and the supply of capital by investors on the capital markets shows some striking differences between Italy and the UK in the financing patterns of companies and the investment attitudes of investors, respectively. The corporate funding model of Italian firms is more bank-centric and more leveraged. Consequently their demand for funds on both debt and equity capital markets is more feeble. In addition, in terms of the supply of capital, the investor base in Italy is comparatively undersized, especially with respect to domestic investors. Equity and corporate debt securities are also relatively underrepresented in the asset allocation choices of Italian investors. The comparative underdevelopment of capital markets in Italy is also characterized by both lower demand for capital by companies and lower supply of capital by investors.

In light of all this, to what extent can these cross-country differences in demand and supply of capital be attributed to disparity in the regulatory and fiscal framework under which firms and investors operate in the two countries? We try to address this question by linking cross-country differences in regulation and taxes to firms' capital structure decisions and investors' asset allocation choices. Our approach falls short of establishing a causal link between the regulatory or fiscal framework and the development of the capital markets. Nonetheless we do provide an indication on what differences need to be smoothed out in order to foster the development of Italian capital markets by benchmarking their UK counterparts.

On the one hand, the cross-country differences we observe in corporate funding, and thus in the demand for capital, could be due to cross-country discrepancies with respect to various factors. These may include the informational costs associated with issuing alternative forms of financing, or the cost of financial distress, or the tax shield on debt.

European-level directives harmonize across countries the issuance of securities on regulated markets, investor protection and bankruptcy laws. These norms should, in theory, level cross-country differences in the informational costs associated with issuing alternative forms of financing or the costs of financial distress related to excessive recourse to debt financing. However, while fully compliant with EU laws, national procedures and supervision by national authorities may still leave room for some cross-country divergence.

Looking at the AIMs alone, which should contribute the most to funding the economy, we can observe a few regulatory differences which could raise the informational cost of issuing equity in Italy. This in turn discourages the demand for equity capital by Italian firms and causes their undercapitalization. In the UK, for example, the total average fees on an AIM admission depend on the nature of the company coming to the market, which subsequently affects the nature and level of due diligence needed. The base level for admission costs would normally be in the range of £350,000 - £450,000. On top of these fees, the company will need to pay the broker's fees for raising funds (unless the AIM listing is by way of an introduction), which could run from 4% to 6% of the funds raised. The key adviser that a company needs for an AIM listing is a nominated adviser (a "Nomad"). The whole process, from the appointment of advisers through to admission, would normally take about 12 weeks. A company seeking admission will have to produce either an 'AIM-PD' admission document or a more detailed European Prospectus Directive (PD) style prospectus. AIM–PD omits some of the requirements of the PD and does not need to be approved by the UK listing authority of the Financial Services Authority ('UKLA'). The UKLA requires 20 business days to approve documents relating to an AIM admission, or 10 business days for subsequent capital raising. No approval is required for an AIM-PD admission document, which is instead signed off by the company's advisers. As for the regulated markets, there are two main exemptions that companies are likely to rely on to avoid the need for a PD prospectus on admission to AIM: offers restricted to professional (or 'qualified') investors; or to fewer than 150 people, other than qualified investors, per European Economic Area state. In practice, many companies structure their fundraising initiatives in keeping with these parameters, to circumvent the PD prospectus requirement. Another exemption for this requirement, (albeit one that will not be relevant to most companies) is when the total consideration for the offer is less than €5 million.

In Italy, the AIM was designed based on the UK model. The shorter time necessary for admission compared to the main market is conceived as a way to offer both a simplified listing process and at the same time post-listing formalities gauged on the structure of small and medium-sized companies. In contrast to the regulated markets, there are no limitations as regards the minimum or maximum size of the company in terms of capitalization. What is more, in terms of the free float, a minimum threshold of 10% is sufficient. No particular requirements are envisaged pertaining to corporate governance, and there are no specific economic or financial requisites. Also in this case, whenever there is no initial solicitation to the public, the company can prepare a simplified admission document which does not need to be approved by CONSOB. So as far as the main ongoing obligations, the company must prepare an annual financial statement and half-yearly reports, comply with the price-sensitive rule, and employ a specialist to secure the liquidity of the stock on the secondary market. However, seeing as the Italian AIM is in its early stages and is less attractive to investors, the result may be diseconomies of scale which could discourage the requests for listings even if in terms of fees the cost to access the market are not different across countries. In this framework, an essential element would be a policy expanding the equity AIM through tax concessions to firms that are open to external ownership. In this regard, one item on the agenda of Italian policymakers is the possibility of introducing a temporary corporate tax reduction for SMEs, as well as tax relief to companies whenever they grow externally, or undertake mergers or acquisitions.

In a similar way, looking at the less regulated market for Minibonds, what seems to discourage the demand for disintermediated debt by Italian firms is the higher cost of financial distress if their debt is in the form of bonds rather than loans. This is due to the complex and lengthy restructuring procedures prescribed by bankruptcy laws and the inefficiencies in judicial procedures. All this reinforces the bank-centrism of the Italian corporate funding model.

Last but not least, debt has a fiscal advantage over equity both in Italy and in the UK because interest payments are tax deductible, although with a backstop of up to 30% of EBITDA. However, as the corporate tax rate is higher in Italy than in the UK (27.5% plus 3.9% regional tax on productive activities, as compared to 20%), tax deductibility of interest on debt generates, ceteris paribus, a comparatively larger tax shield on debt in Italy. As a result, the fiscal advantage of debt over equity is even stronger in Italy than in the UK, potentially hindering the demand for equity capital. However, a fiscal incentive is currently in place to boost the recourse of Italian companies to equity financing and to foster their capitalization. In particular, under the ACE relief scheme (Support for Economic Growth), introduced in 2011, Italian companies and Italian branches of non-resident companies are entitled to an income tax deduction, computed as a percentage of the annual increase in the company's net equity (i.e. a notional interest deduction). The deduction is 4.5% for the fiscal year 2015 and will be 4.75% for 2016. From 2017 this percentage will be determined annually by a ministerial decree that will take into account the yield of Italian Treasury bonds; the deduction could be increased by an additional 3% to factor in business risk. On top of that, several other fiscal relief initiatives are currently on the agenda of Italian policymakers: such as the possibility to deduct IPO costs and to accelerate their amortization. These incentives, while not specifically targeted to the development of the AIM, would be especially effective in facilitating access to the market to the very small- and medium-sized enterprises which this market was actually designed to serve.

On the other hand, the cross-country differences we observe in investors' asset allocation decisions, which impact the supply of capital, could be due to various factors. Examples are cross-country differences in investors' rights across alternative asset classes, or dissimilar tax regimes, or regulatory constraints limiting the exposure of institutional investors to some asset classes, or non-identical pressure imposed in terms of financial reporting and corporate transparency.

In this regard, since 2014 income from financial investment in Italy is taxed at the single withholding tax rate of 26%, whether it comes from interest, dividends or capital gains. Only income from government bonds and certain other equivalent eligible securities is subject to a 12.5% rate. In the UK however, income from interest is taxed at 20% while the tax rate applied to capital gains is progressive and capped at 28%. In addition, within the framework of Individual Savings Accounts, income or capital gains on investments in cash, stock, shares and insurance policies are tax exempt up to a maximum allowance, which for the 2015/2016 fiscal year amounts to £15,240. These cross-country divergences may contribute to explaining the different asset allocation choices of investors in Italy and the UK. The fiscal regime in Italy, indeed, artificially favours allocation to government issues and thus diverts resources away from the supply of capital on corporate debt and equity markets. The tax regime in the UK is instead friendlier with respect to asset classes such as corporate debt and equity, promoting savings in the long-run.

With respect to investor taxation, AIMs deserve a closer look. In the UK in fact many fiscal incentives are in place to promote the interest of investors for stocks traded in the AIM, in turn supporting the supply of equity capital. For example, while upon the death of an individual, inheritance tax will often be due on the full value of any listed shares held at the date of death, shares in AIM companies are usually exempt from inheritance tax, provided that the shares have been held for at least two years (unless the company is a dealer in financial instruments, a property company or an investment company). In addition, enhanced loss relief is available for certain investments in unquoted trading companies, allowing individual investors who suffer a loss due to capital gains tax upon the disposal of these shares to claim relief against their taxable income. Furthermore, UK stamp duty and stamp duty reserve tax (SDRT), generally at 0.5%, is no longer charged on any transfer (including to a depositary receipts regime or clearance service) or own purchase of AIM-quoted shares and securities. Finally, shares traded on AIM can now be held in the main tax exempt savings scheme available to UK residents (known as individual savings accounts or ISA). These are all general incentive targeting all companies listed on AIM, however a few specific schemes are also in place:

- Enterprise Investment Scheme ("EIS") applies to companies with gross assets under £15 million before the shares are issued and £16 million after. If an AIM company qualifies under EIS, certain tax relief provisions and benefits will be available to individual British investors in the AIM company. For example, individuals who subscribe in cash for new ordinary shares in a qualifying EIS company may be able to reduce their UK income tax liability for that year by an amount equal to 30% of the sum invested; the maximum investment is £1 million. In addition, provided certain conditions are satisfied, individuals will be able to sell their investment without a capital gains tax liability. There are also other EIS benefits with respect to losses and the ability to defer capital gains. Individual investors in a company with a full listing would not qualify for EIS relief;
- Seed Enterprise Investment Scheme ("SEIS") can also apply to investments in AIM companies, offering individual investors similar tax relief to EIS. However, SEIS is limited to very small companies;
- Venture capital trusts ("VCTs"). A VCT is a fully listed company, similar to a quoted investment trust which is approved as such by HM Revenue and Customs. This type of trust mainly invests in companies with gross assets under £15 million before the shares are issued and £16 million after, which do not have a full listing. In a similar way to the EIS, individuals who subscribe for eligible shares in a VCT may be able to reduce their income tax liability by an amount equal to 30% of the sum invested, subject to a maximum of £200,000. Additional benefits include an exemption from tax on dividends received from the VCT and an exemption from capital gains tax on disposal of the VCT shares. In addition, the VCT itself is exempt from tax on chargeable gains on disposal of its investments. The maximum annual amount that an investee company may raise from any single VCT is £1 million;
- Remittance basis business investment relief allows individuals ("Remittance Basis Users") who are UK residents but not UK domiciled to remit foreign income or gains to the UK to make a "qualifying investment" without the foreign income or gains being charged UK taxes (as they otherwise would be under the remittance basis of taxation). The issue of shares in an AIM company to a Remittance Basis User can be a "qualifying investment" for the purpose of this relief. Note that the amount that an investee company can raise annually under the EIS, SEIS, VCTs and other "risk capital schemes" must not exceed £5 million.

In contrast, none of these incentives is currently in place in Italy to support the supply of capital to firms seeking equity financing on the AIM. While there is no substantial difference across AIMs in Italy and the UK in terms of regulatory framework, the Italian market falls short of benchmarking its UK counterpart with respect to fiscal incentives offered to investors.

The supply of capital in the UK is further supported by a broad base of institutional investors. In the UK, policymakers have always supported the asset management industry and the development of a private pension pillar, which plays a determinant role for corporate funding. In Italy, where the pension system is mostly public and thus centralized, there are fewer private pension funds and their asset allocation is excessively oriented towards real estate and government debt securities. Instead, equity is a largely underexploited asset class, especially considering the long-term investment horizon of these investment vehicles. Indeed, according to Bank of Italy estimates, while in the UK institutional investors account for approximately 57% of all invested capital, in Italy they represent only 24%. A possible explanation could be that, broadly speaking, the UK authorised fund tax regime aims to achieve tax neutrality whereby investors in a fund would achieve a similar tax result had they invested in the assets directly. In addition, most UK funds pay no tax and their investors can benefit from one of the most extensive tax treaty networks in the world, offering investors clear tax advantages on a range of investment products and asset classes. The UK's tax administration (HM Revenue & Customs) has a specialist team dedicated to the administration of tax affairs relating to funds, which ensures that UK funds benefit from a proactive approach to tax policy and certainty of tax treatment. More specifically, UK funds are subject to a corporation tax rate of 20% on their taxable net income. However, very few funds are subject to income tax in practice. This is generally either because they benefit from the exemption from tax on dividend income, or distributions are deductible from the fund's taxable profits. In particular:

- **For equity funds**: Dividend income is exempt from tax in the UK. Any residual taxable interest income is usually fully offset by allowable expenses of the funds. Hence equity funds are rarely liable for corporation tax;
- **For bond funds**: Funds that invest more than 60% of their portfolio in interest-bearing assets are known as bond funds. Distributions paid by bond funds are treated like interest by the investor. The interest distribution is deductible from the fund's taxable profits, and therefore bond funds do not have any taxable net income when pursuing a full distribution policy.

On top of that, UK-authorized investment funds are exempt from tax on gains and investors are then taxed only on the gains made on the sale of units in the funds. The management of a similar fund is exempt from VAT and there is no UK capital taxes on funds.

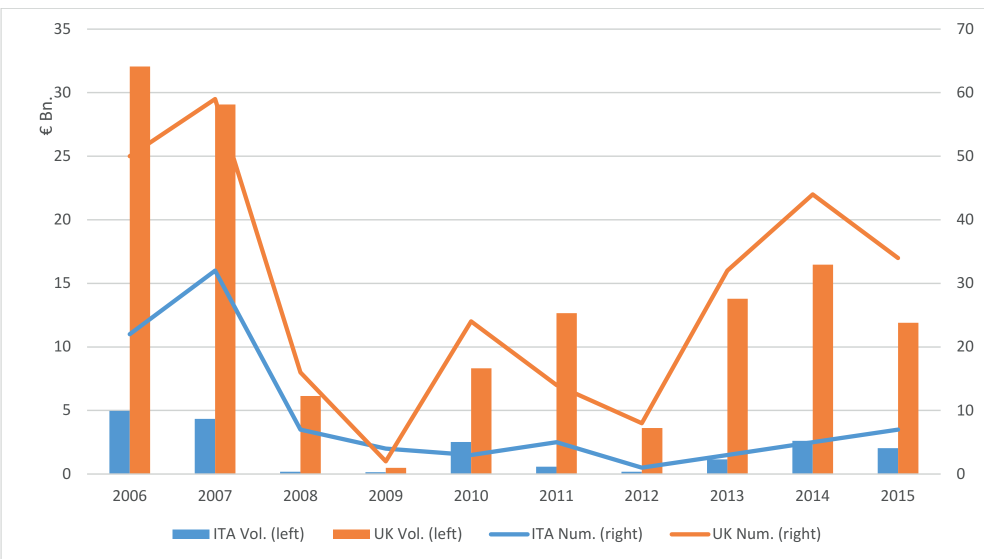
On a comparative basis, not only is the fiscal regime in which Italian institutional investors operate less friendly, but they have also historically been subject to more stringent limitations on their investment choices. For example, with respect to pension funds, it was only in 2014 with the new framework governing second-pillar pension funds investment (DM 166/2014) that the principle-based approach replaced the previous prescriptive regime, increasing the range of opportunities available for asset allocation. Quantitative limits have been rolled back and the inclusion of alternative investments has been allowed to a greater extent, also in emerging markets. The new approach gives pension funds much more freedom, and the main development in asset allocation that is likely to result is an increase in diversification without changes in the risk profile of funds. As a consequence, the supply of capital by pension funds to debt and equity capital markets is expected to improve in Italy as well.

A Comparative Analysis of IPOs in Italy and the UK

Do these cross-country differences in regulatory and fiscal frameworks impact access to the markets and their structure? To answer this question we provide a comparative analysis of recent IPOs in Italy and the UK to link market development to post-IPO performances, and to shed light on some procedural differences that may affect market structures.

In our analysis, we consider all IPOs reported by Dealogic – ECM Analytics in Italy and the UK from 2006 to the end of the third quarter of 2015. Overall, our sample comprises 1173 IPOs for an aggregate total value of approximately €185 trillion. The contribution of Italian capital markets to total deal flow in the two countries is dismal. IPOs in Italy represent only 12% of the total number of IPOs realized in the period, and approximately 10% of aggregate IPO volume. We split our analysis between main markets and alternative investment markets (AIMs). While in Italy the alternative market accounts for 35% of transactions and approximately 3% of IPO volume, in UK it represents respectively 73% of IPO flow and 19% of IPO volume. In this respect, Italian capital markets are comparatively underdeveloped, but especially so when considering AIMs. *Figures 10* and *11* compare IPO deals flow in Italy and the UK since 2006, respectively in the main markets and in AIMs. We interpret these differences in IPO flows across countries as evidence of how Italy's bank-centrism has conflicted with and actually hindered the development of capital markets.

FIGURE 10
IPO deal flow 2006-2015Q3: Italy vs. UK – Main Markets



Source: authors' elaboration of Dealogic data

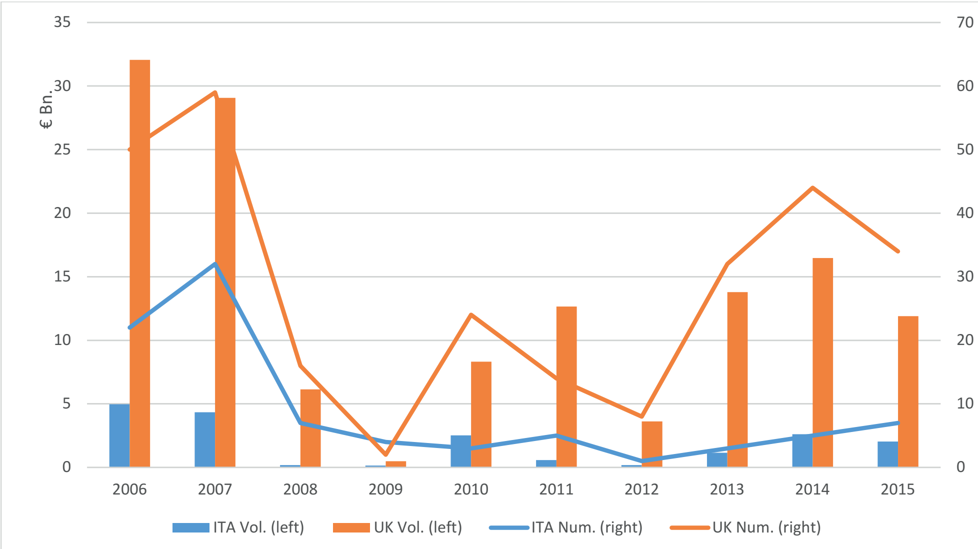


FIGURE 11
IPO deal flow 2006-2015Q3: Italy vs. UK – AIMs

Source: authors' elaboration of Dealogic data

The industrial sector has provided by far the largest contribution to IPO flow across all markets. However, in the UK the financial sector has played a more substantial role than in Italy, both in the main market and the AIM. *Figure 12* shows the sectoral breakdown of IPO deal flow.

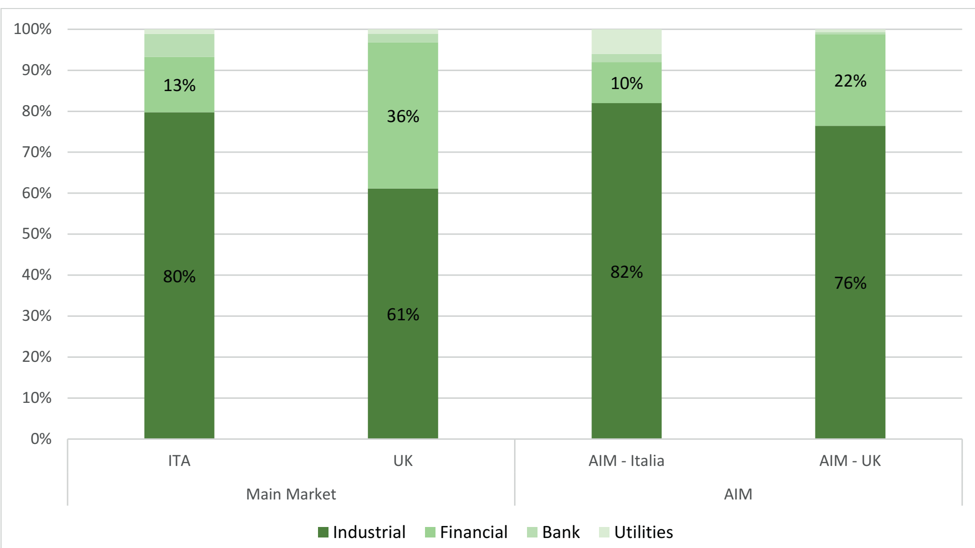
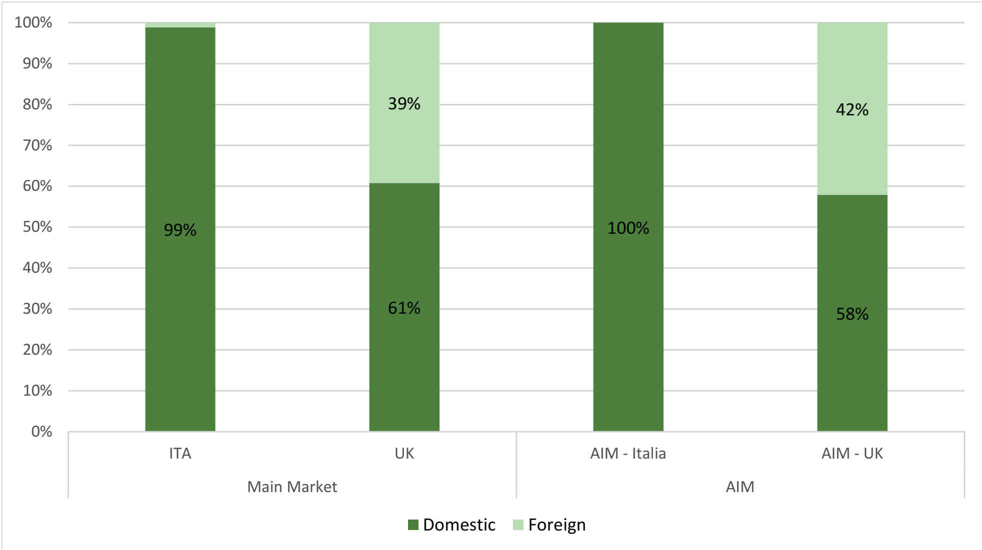


FIGURE 12
Sectorial breakdown of IPO deal flow 2006-2015Q3: Italy vs. UK, Main markets (left) and AIMs (right)

Source: authors' elaboration of Dealogic data

While only domestic companies access capital markets in Italy, a substantial portion of IPO deal flow on UK capital markets is made up of foreign companies. *Figure 13* compares the geographical breakdown of IPO flow across the different markets, in terms of country of origin of the issuer. What emerges is a striking divergence with respect to the attractiveness of the two markets. The proportion of foreign issuers to total IPO flow in the UK shows how the costs of issuing equity in this country from abroad are more than offset by the benefits of gaining access to deeper pools of capital and a more efficient stock market.

FIGURE 13 Geographical breakdown of IPO deal flow 2006-2015Q3: Italy vs. UK, Main markets (left) and AIMs (right)



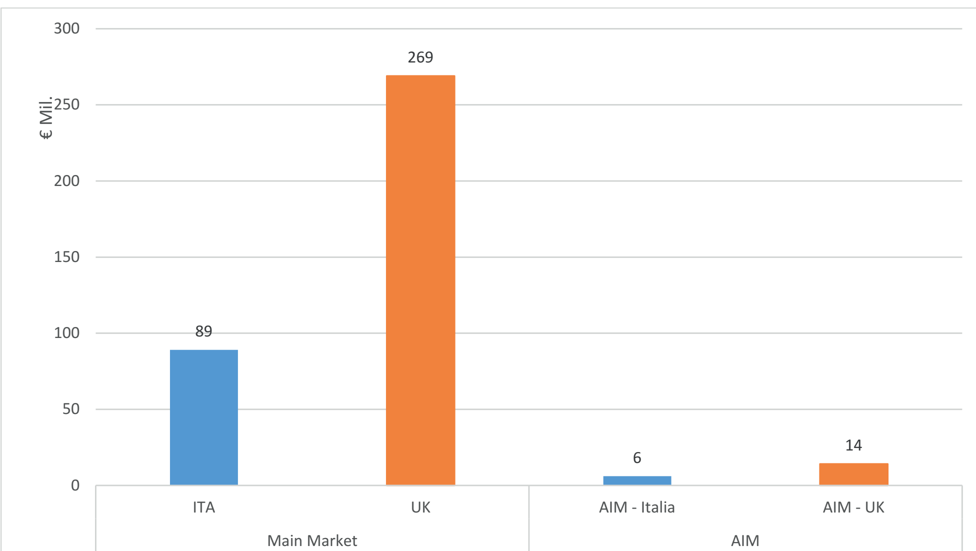
Source: authors' elaboration of Dealogic data

A few different procedures and regulations for IPOs may help explain the variations we observe across the two countries. Indeed, even if the regulatory framework is aimed at ensuring homogeneous approach all across Europe, national authorities maintain some degree of discretion in their approaches. In this respect, CONSOB appears to play a more prominent role than the UK Listing Authority. The latter uses its supervisory function to control formal compliance with regulations and procedures, and verifies e.g. that the risk factors in the prospectus are compatible with the status of a listed company. Instead, CONSOB considers its mandate in broader terms and also verifies in greater detail the substance of the disclosure offered to investors. This may be a consequence of the fact that CONSOB bears legal responsibility compared to UK Listing Authority. Consistently, the temporal framework in which the two supervisors act is the same, as regulated by European laws (see Art. 94-bis comma 2 of TUF and for the process of authorization see Art. 8 of Regolamento Emittenti). But CONSOB also tends to request additional disclosure and information more frequently, thus exploiting in full the maximum 60 days allocated for the process (as per Art. 8 Regolamento Emittenti). As a consequence, the prospectus in Italy is longer and more complex, even without considering the fact that it has to be drafted in two different versions: one in Italian, the Prospetto

Informativo (approved by Consob), and one in English, the Offering Circular (not subject to Consob approval), a document needed to market the issue to institutional investors during the road-show and offer period. On top of that, in Italy, while CONSOB is in charge of the due diligence of the prospectus, Borsa Italiana undertakes a due diligence of the issuer. This process requires the issuer and its sponsor to make several declarations and draft numerous documents (e.g. on the sponsor side alone: the business plan, the Qmat, a memorandum on the mechanism for corporate governance and management control, and a valuation). In this regard too, the approach of the London Stock Exchange in the UK is less demanding; on the other hand, more responsibility is ascribed to the sponsor.

Another structural difference across markets emerge in terms of deal size. As expected, IPOs on the main markets are larger on average than IPOs on AIMs, but while in the main markets the average IPO in the UK is approximately three times the size of the average IPO in Italy, in the AIMs this gaps widens to approximately four times. *Figure 14* compares IPO median deal value in Italy and UK across different markets. The median IPO deal value on the AIM in Italy is only approximately €6 million against the €14 million of the median IPO on AIM in the UK. Both differences in the medians across countries are statistically significant at the 1% level. This is consistent with the notion that the former market is not yet as effective and efficient as the latter to provide corporate funding to a broader set of companies, since at this stage Italy's AIM is not as liquid.

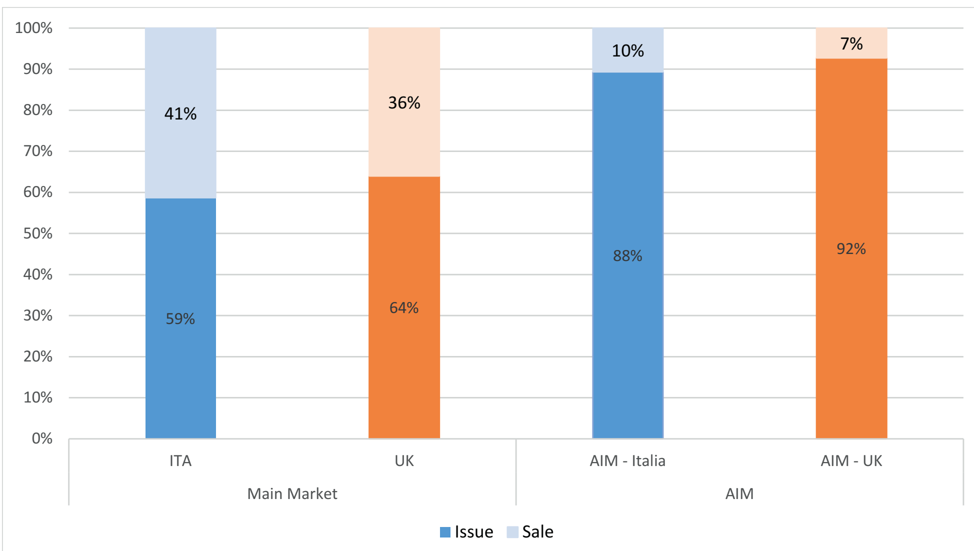
FIGURE 14
IPO median deal value 2006-2015Q: ITA vs. UK, Main market (right) and the AIM (left)



Source: authors' elaboration of Dealogic data

These differences are consistent with the fact that a larger stake is usually floated in IPOs in the UK: For the main markets the average is 53%, against 41% in Italy, while in the AIMs the difference is 46% in UK versus 26% in Italy, both statistically significant at the 1% level. There are also structural disparities with respect to the nature of the stocks in the IPO. *Figure 15* compares across markets the proportion of existing shares sold by shareholders to newly-issued stock. As expected, IPOs on the main markets involve a larger proportion of existing shares sold by shareholders than IPOs on AIMs, where companies mostly issue new shares. Still, even if both in Italy and the UK newly-issued stocks exceed the stocks sold by shareholders, in the UK the proportion of shares issued by the company is on average larger than in Italy. In particular, for the main markets, shares issued by the company account for 64% of the total issue in the UK, against 59% in Italy, while in the AIMs the difference is 92% in the UK versus 88% in Italy. Such differences however are not statistically significant, as we cannot reject the null hypothesis that average proportions of shares respectively issued and sold are homogeneous across countries. In both countries, then, the fundraising function of equity capital markets dominates the mere transfer of ownership, and especially so in the AIMs.

FIGURE 15
Breakdown of IPO shares 2006-2015Q: ITA vs. UK, Main market (right) and the AIM (left)

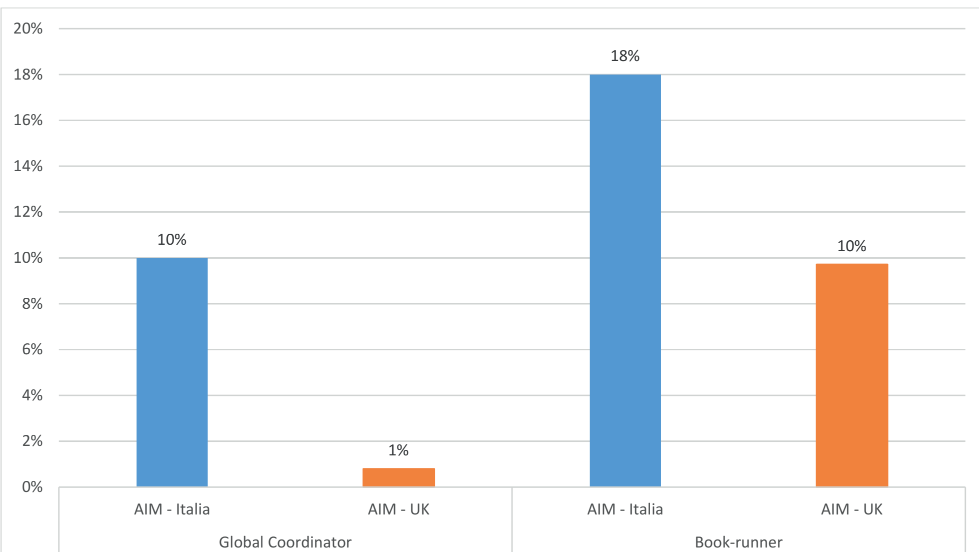


Source: authors' elaboration of Dealogic data

The role of intermediaries in IPOs does not differ across main markets, but on the AIMs, a greater variety of global coordinators and book-runners are involved, especially in Italy. Both the average number of global coordinators and bookrunners is larger in Italy, and such differences are statistically significant at the 1% level. In keeping with this finding, *Figure 16* compares the frequency by which more than one global coordinator or more than one bookrunner is involved in an IPO.

Syndication is more common in Italy, where market conditions are more uncertain. This is also consistent with the fact that "direct retail offerings" are very rare in the UK; usually stocks are issued in "intermediary offerings", where the Global Coordinator of the issue sells the shares to an institutional investors who then does the same to retail investors such as family offices, brokers and private bankers. This potentially limits the risks for the Global Coordinator substantially and thus the incentive to syndicate.

A further explanation of the larger number of intermediaries involved in Italy could be that while it is not uncommon in this country for banks to act as lenders to a company and at the same time play a part in its IPO, in UK the different roles are usually kept separate to avoid potential conflicts of interest. Indeed, if we compare cross-country the frequency with which universal banks are appointed as Global Coordinators for the IPOs in our sample, we observe that in Italy it is much more common to find banks that serve as both lenders of the listing company and have a leading role in its IPO. Indeed, in Italy banks that we identify as potential lenders to the listing company are preponderant, and the three most active universal banks alone account overall for more than 20% of all Global Coordinator mandates for the IPOs in our sample. In the UK, instead, investment banks and specialized advisors are most often awarded Global Coordinator mandates, with banks that we identify as potential lenders accounting for only around 6% of total IPO deal flow.

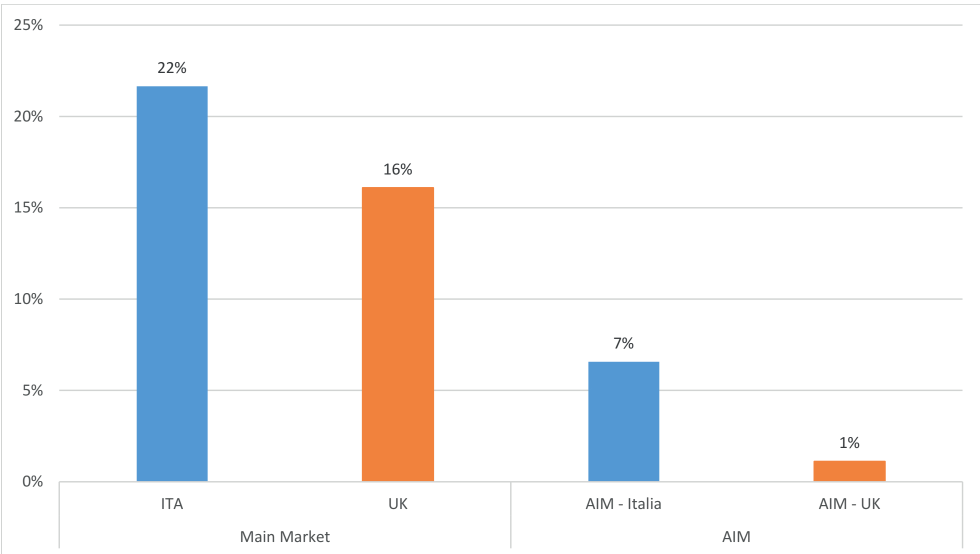


Source: authors' elaboration of Dealogic data

FIGURE 16
Size of the syndicate 2006-2015Q: ITA vs. UK, AIM, frequency of multiple global coordinators and multiple book-runners

Larger syndicates do not seem to translate in any significant advantage, but rather seem to be a response to the greater challenges faced to when pricing an issue in Italy. Indeed, *Figure 17* compares the pricing range at filing across markets, computed as the difference between the upper and the lower bound over the lower bound. The pricing range at filing is on average wider in Italy than in the UK, both in the main markets and the AIMs. Differences across countries are statistically significant at the 1% level, and are consistent with the Italian markets being structurally more volatile than the UK ones. Likewise, in the UK a company that is willing to list its shares files its application with the UK Listing Authority and the London Stock Exchange, but no press release is required at that time. In Italy however when a company files an application with CONSOB and Borsa Italiana a press release is issued. In the UK, such information is disclosed just a few days before the pricing of the issue, thus in proximity of the listing.

FIGURE 17
Price range at filing 2006-2015Q: ITA vs. UK, Main market (left) and AIM (right)



Source: authors' elaboration of Dealogic data

Given the structural differences across countries and markets, how do these reflect on IPO performance? *Figure 18* compares IPO underpricing across the markets in question. We compute underpricing as the percentage difference between the close price at the end of the first day of trading with respect to the offering price and the performance of the benchmark index. Underpricing is on average higher in Italy than in UK in the main markets, while the opposite is observed in the AIMs. Both differences are statistically significant, respectively at the 1% and 10% level. The same cross-country discrepancies are also observed in terms of standard deviations. Underpricing is more volatile in Italy than in UK in the main markets, while we find the opposite in the AIMs.

Is this a consequence of the different structure of the markets? A within-country analysis seems to indicate as much. In the more developed UK markets, underpricing is on average higher in the AIM market than in the main market, as should be expected due to the higher informational costs for investors in the former. However, in Italy underpricing is higher in the main market rather than in the AIM. We attribute this contrast in underpricing to the diverse context in which these transactions occur. In particular, the comparatively low underpricing of the issues in the Italian AIM is due to the lack of trade volumes large enough to move prices after the IPO. Stocks issued on the AIM in Italy are indeed offered at a substantial discount due to the more severe informational problems and specifically for the subsequent lack of liquidity. But underpricing in this case fails to reflect the discount because post-

IPO trade volumes are too low to move prices in such a short horizon. The low post-IPO trade volumes on the AIM in Italy are mainly due to the absence of a strong domestic investor base, the small size of the issues, and the scarce liquidity of the stocks which discourages foreign investors. Those investors interested in one issue would be able to get the shares in the IPO and would then find it hard to liquidate their holdings in the short-term, dying up liquidity in the immediate post-IPO trading phase.

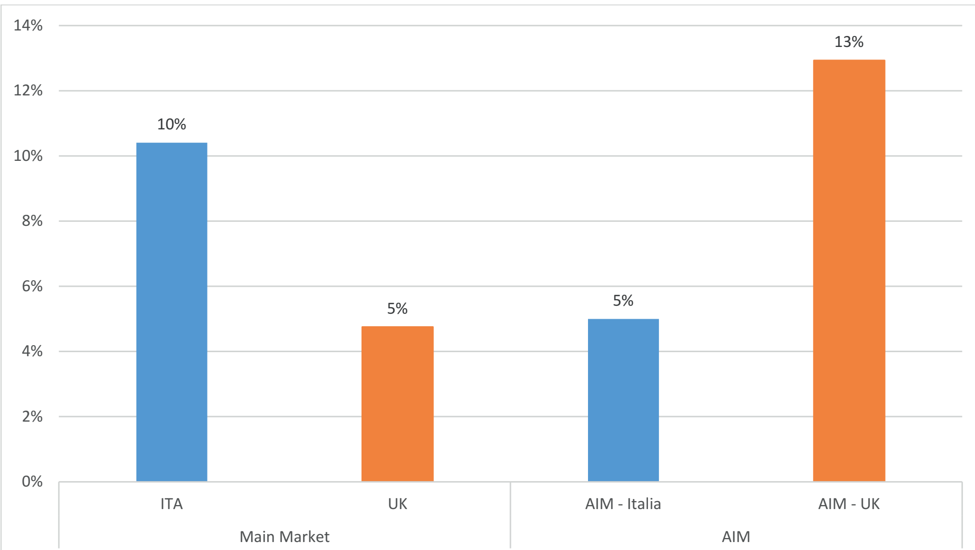


FIGURE 18
IPO underpricing 2006-2015Q: ITA vs. UK, Main market (left) and AIM (right)

Source: authors' elaboration of Dealogic data

To support this argument, since we consider a moderate level of underpricing physiological for any successful IPO (i.e. in the range between 0% and 10%), we further investigate first-day abnormal performance for IPOs (i.e. with respect to the benchmark index). We want to see whether there is any evidence of cross-country differences in the frequency with which IPOs realize respectively a first-day negative performance or an overperformance in excess of 10%. The goal is to highlight structural differences across countries and markets in the pricing of IPOs. *Table 8* shows that negative first-day abnormal performances are almost two times more common in Italy than in the UK, especially in the AIM where post-IPO liquidity is scarce. On the contrary, the relative frequency of abnormal performances in excess of 10% is not significantly dissimilar across markets and countries.

TABLE 8
Mispricing in IPOs in UK and Italy, 2006 – 2015Q3

	IPO first-day abnormal performance	
	Negative (Frequency)	**In excess of 10% (Frequency)**
Italy Borsa Italiana	33.71%	25.00%
UK London Stock Exchange	24.38%	21.20%
AIM - Italy	24.00%	34.00%
AIM - UK	11.98%	39.00%

Source: authors' elaboration of Dealogic data

Also with respect to long-term IPO performance, we find some striking disparities between Italy and the UK. *Figure 19* compares post-IPO long-run performance across different markets. We compute said performance as the one-year return on stock in excess of the corresponding market index. Performance is on average better in Italy than in the UK in the main markets, while the opposite is observed in the AIMs. Again, in the more developed UK markets, the performance is on average higher in the AIM than in the main market, as expected due to the smaller size and the higher risk of the companies listed here. In Italy, however, this argument does not hold and we find the long-run post-IPO performance is negative on the AIM.

In this context, disparity in long-run performance across countries seem rather to be driven by the structure of the supply and demand of capital in the market. Indeed, a possible interpretation of this evidence, which is also consistent with what we observe for underpricing, could be that very large and very small deals are harder to market in Italy, because of the lack of a solid investor base and the consequent structural shortage of supply of capital. IPOs in Italy are priced too conservatively on the main market and then overperform in the subsequent year as the market corrects the initial underevaluation. On the AIM instead, where the issue size is very small, investors are discouraged by the diseconomies of small scale investments, especially foreign ones, and the lack of liquidity, which dampens the performance of the stocks.

The good performance of the firms listed in the UK markets may then reflect the fact that UK firms are better than Italian firms at communicating to investors. Indeed, in the UK all listed companies have a Corporate Broker facilitating both the flow of information from the company to the market and the trading of the stocks. In Italy, instead, there is no legal obligation to have any professional advisor in charge of assisting a company's communication with the market. The only exceptions are companies listed on the STAR segment of the main market, which are required to be backed by a Specialist, and firms listed on the AIM who need to be assisted by a Nominated Advisor (i.e. Nomad).

FIGURE 19
Post-IPO long-run performance 2006-2015Q: ITA vs. UK, Main market (left) and AIM (right)

Source: authors' elaboration of Dealogic data

Conclusions

In this report, we have carried out a benchmarking exercise involving the UK and Italian contexts. The objective was not to identify what is good (or better) and what is not. We have compared the two countries to show how a different political economy view can impact the functioning of financial markets, the behaviour of investors, and the financial policies of corporations.

Data reported in the paper clearly indicate a convergence of the two financial systems.

On one side, Italian companies are becoming less reliant on bank lending and more prone to exploit the potential of liquid debt capital markets. Furthermore, the recent wave of privatization of State-owned entities is reviving the favourable experience of the first round, dating back some years ago. The process is not fully completed but it will necessarily move forward in response to the massive bank restructuring still ongoing under the pressure of new Basel III rules, the implementation of MREL regulations and the need to optimize credit risk and balance sheet structure. For a country like Italy, this will mean lower credit availability from the banking sector and the need to develop alternative funding channels.

On the other side, the UK is also undergoing important changes, for example, recent actions undertaken by the Bank of England requiring the ringfencing of commercial banking activities from the reputedly riskier investment banking ones. These rules will generate a scenario where the segmentation of the market will be sharper than today; SMEs will probably be closer to the more traditional banking channel and larger corporations will be the obvious customer for ringfenced investment banks. The recent consultation paper on MREL enactment in the UK will also push forward this segmentation.

So, while the two countries are moving toward the path of convergence, our report still identifies key elements of distinction between the two contexts that do not involve the demand (the investors) and the supply (the issuers) of financial instruments but rather the institutional design of the financial system.

From this point of view, what emerges from the UK landscape is favourable tax treatment, streamlined rules for listing (which does not necessarily mean simplified), and a well-diversified group of institutional investors able to provide funds for the different stages of the life of the company. The combination of these factors truly makes the difference if compared to the behaviour of Italian companies, which is still over-reliant on bank lending.

Many steps have been already implemented in Italy and many are still in the policymaking agenda. The benchmarking exercise of this paper might indicate further ideas to accelerate the reform of the Italian financial system.

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Notes

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