LOCAL BANKS AND PRIVATE EQUITY: *CULTURAL AND ORGANIZATIONAL CHALLENGES IN LIGHT OF THE INTERNATIONAL FINANCIAL CRISIS*

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ABSTRACT

This paper will describe any changes brought about by global financial crisis on the Italian private equity market analyzing contextually supply and demand characterizing this kind of financial sector.

We have tried to trace briefly the evolution of the individual bank role and, in particular, of the local bank, in the activity of private equity in support of nationwide companies, making two analyzes: first of all a descriptive one then an empirical one.

After an initial description of the distinguishing characteristics of an intermediary credit institution acquiring the character of a "local bank" with a brief review of recent literature and a description of the impact of regulation and legislation on the role of lenders in the market risk capital , we analyzed the trend of investment in private equity and venture capital, based on the data collected annually in the investigation conducted by AIFI (Italian Private Equity and venture Capital Association) in collaboration with PricewaterhouseCoopers.

Keywords: regional systems of innovation, technology districts, financial crisis, private equity, merchant banking, local banks

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1 INTRODUCTION: RESEARCH QUESTION AND STRUCTURE OF PAPER

This paper aims to describe the possible changes brought by the global financial crisis on the Italian private equity observing the same side of the supply and demand characterizing the financial sector.

On the demand side, we have tried to respond to the attempt to describe the main any impact of the financial crisis in terms of the trend of the industry and sector characteristics, size and profitability of the target companies.

On the supply side this work intends to verify whether, as a result of the global financial crisis, the category of intermediary bank represented by local banks (ie banks and credit co-operative banks) has changed its modus operandi in order to assume the appearance of more intermediary diversified business areas of corporate and investment banking and in particular of merchant banking business area.

With reference to the latter we have tried to trace briefly the evolution of the role of the subject bank and, in particular, the local bank in the activity of private equity to support businesses nationwide.

This research is part of the studies on regional innovation systems and in particular seeks to understand the role that innovative finance can exercise in technological districts, in fact, the availability of finance for innovation exerts a significant influence on the potential innovation of any land area and businesses located there.

On the contrary, the contexts in which you can not delete information asymmetries may generate market failures slowing innovative activity.

The intangible nature of the factors of development of technology clusters and the lack of physical assets to secure lines of credit necessarily require a transformation of the traditional sources of business financing district.

Local banks, compared to other categories of intermediary bank by leveraging its strengths related to the vocation of territorial strategic focus on the philosophy of relationship lending would have an advantage in the reduction of such information asymmetries.

Another factor that makes it ineffective in technological districts the bank-firm relationship can be attributed to the limited appropriability asset knowledge that makes it difficult for companies to explain to lenders the subject of research projects for which it is required financing.

Small and medium-sized enterprises then try to work around these obstacles using their margin of self-financing if the amount is sufficient, otherwise the lack of self-financing is a serious constraint to the growth of small and medium-sized enterprises in the redistricting technology.

An important way that these companies may decide to follow when you are in these conditions is represented by the capital market risk identified most commonly in the financial techniques of venture capital, private equity and mezzanine financing.

The first part leads to an analysis of the mode of action of banking intermediaries and in particular of the local banks in the activity of private equity to support nationwide businesses

The second part offers a description of the main effects of the financial crisis International, which began in 2007 on the financial sector of the private equity with particular reference to the choice of the geographical location of target companies and their main sectoral characteristics, size and income in order to verify a possible co-evolution of the business and finance for innovation in the country.

The third section shifts the focus on advanced financial services falling within the scope of business of the merchant banking as factors supporting the technology districts with the main objective to verify through empirical analysis, if local banks operating in regions of these districts are able to offer these products and financial services to businesses.

2 EVOLUTION OF THE MODEL OF INTERVENTION BY LOCAL BANKS WITHIN PRIVATE EQUITY

This paragraph[3] aims to briefly outline the role of the individual bank and, in particular, the local bank, acting as private equity in support of nationwide companies.

The inherent regulation and legislation have affected the credit institution role in venture capital market.

In Italy it was the CICR Resolution, and the relative Circular issued by the Bank of Italy on 1987, to enable the banks to invest in venture capital from industrial enterprises. The activity could only be done indirectly, through financial intermediary entities having direct emanation, the so-called merchant banks.

[3] " The section 2.2 and 3 were edited by Dr. Alessandra Bechi"

Subsequently, the Consolidated Banking Act (Legislative Decree no. 385/93) finally overcame the principle of "separation between banking and industry" and made it possible for banks to take direct investments in non-financial companies.
In carrying out this task some constraints were imposed to protect the risks to which the bank could be exposed, through the identification of maximum investment, both with reference to the bank regulatory capital, and with reference to the investee capital (Forestieri, Corbetta 1996).
The principles introduced by the Consolidated Banking Act involved, for many merchant banks, a rationalization of the sector through the internalisation of acquisition of shares in the reference group, with the dismantling of the existing operational structures.
Furthermore, 1993 was also the year of the birth of closed-end investment funds legislation (Law no. 344, August 14, 1993 Gervasoni, Bechi 2007). Several banks started to promote, through specialized Investment Management Company, in their enactment, the investment activities in companies' risk capital, placing, at their customers, closed-end fund shares.
Somehow, the banks were acting as a driving force for investment in risk capital, both in terms of direct intervention, through the creation of specialized divisions, and promoting the investment activity through the creation of the first closed-end funds, intended for retail customers (Bracchi, Bechi 2005).
In fact, it seems that besides the "pioneer" role in the use of innovative financial instruments, a decisive role was played by the individual bank, as a privileged partner of the company, in spreading the culture of venture capital in the business class.
Therefore, the bank operators have generated an initial forward thrust to the increase in the number of operators in the private equity market, accounting for 50 per cent of the total at the end of the Eighties and settling on a share of approximately 30 percent of the market in the late Nineties.
After 2000, the presence of banking divisions compared with the total number of operators have begun to decline due to the creation of closed-end funds in enactment of the same reference credit groups.
Recently, also this trend was interrupted in the presence of a reduction in the number of IMCs promoted by the banking sector and a growing importance of independent operators (Bank of Italy 2009).

In particular, according to data published annually in the Bank of Italy Reports, it has gone from 19 bank IMCs[4] specialized in private equity, in 40 IMCs of private equity on 2004, to 11 bank-sponsored IMCs, compared to the total number of 59 IMCs acting in private equity at the end of 2010.

As regards the specific role played by local banks (different in structure, reference standards and operating procedures from other credit institutes), the importance of private equity on all the services aimed at businesses has not yet been sufficiently investigated, either in terms of aggregate statistical phenomenon, either in terms of quality.

Certainly, these operators embedding in the territory, resulting from both a social structure that is an expression of the reference context and from a collection of savings, which supports and funds the real local economic development facilitates the connection with the entrepreneurial tissue and the ability to understand and accommodate in a timely manner the growth needs expressed by the companies operating there.

The local bank vocation, therefore, leads to a convergence of interests with the companies operating there.

It happens, in fact, that local banks are perceived, by economic operators of the targeted area, such as centres for economic growth in those areas. Thus emerges the role of local banks as a driving force for growth in the territory.

Among the modus operandi features of those banks are included: the reciprocal control and the so-called *peer monitoring*, which is expressed within the local community and which provides an incentive not to engage in opportunistic behaviour to avoid social sanctions; the long-term interaction between the partners-customers and the local mutual bank, that in Italy is typically represented by the Cooperative Credit Bank (Azzi, Bracchi 2005).

In recent years, the system of cooperative credit banks has expressed the need to acquire a financial instrument specialized in private equity business, creating an *ad hoc* investment management company, with the aim to expand its supply for business customers belonging to the group and focus investments having distinctive value that are mad in the companies' venture capital by individuals belonging to the cooperative credit circuit.

Moving from the analysis of the number and type of operators to the examination of investing in private equity and venture capital, based on data collected annually in the survey made by AIFI (Italian Association of Private Equity and Venture Capital) in collaboration with PricewaterhouseCoopers, we can note that in the last five years there has been a noticeable

[4] Management company whose capital is owned by banks according to an amount higher than 50%.

decrease in investments made by banks (considering both direct investments and those made by IMCs in enactment of banking groups).

We have moved, in fact, from an incidence equal to 21% on the total number of interventions made in the market on 2007 to an incidence of 15% on 2011.

In fact, this trend is justified, among other possible explanations of the phenomenon, with the view that banks, including the local ones, participate in an ever-increasing activity of private equity as investors in the funds, placing this role instead of to that of promoter of investment vehicles, or even direct investor.

We have to consider that, in the last five years, the resources flowed to venture capital market, from the banking channel, amounted, on average, to 28% of total resources, and that the banks have represented, in the same period, the first channel of domestic fundraising, since also the marginal role played by other categories of domestic institutional investors (pension funds, insurance companies, foundations ...).

Table 1- The main sources of domestic collection of capital for private equity and venture capital between 2007 and 2011

	Amount (mln Euro)	Incidence %
Banks	**1.510**	**28%**
Individual Investors	727	14%
Industrial groups	618	11%
Insurance companies	537	10%
Bank and academic foundations	523	10%
Funds of funds	434	8%
Pension funds	424	8%
Public Sector	343	6%
Private equity Companies	108	2%
Other	82	2%
Capital market	71	1%
Total	**5.377**	*100%*

Source: AIFI-PricewaterhouseCoopers

As further proof of this trend, we can mention the commitment of individual banks entities in the Italian Investment Fund, the initiative promoted by the Ministry of Economy and Finance on 2010, which provides small and medium-sized Italian companies, through direct and indirect investments, financial support with expansion capital operations[5].

[5] For more information, see the website www.fondoitaliano.it.

Going into more detail about the characteristics of the investments made by banks, either directly or through funds, the analysis, in the last five years, on the same statistical basis, confirmed an approach substantially oriented to minority investments.
In detail, the phenomenon shows that between 2007 and 2011 expansion interventions (development or minority interventions) made by banks and bank IMDs have represented, on average, 49% of the number of interventions and 46% of volumes, compared with total investment made by banks.

Table 2- Distribution of the type of investments in private equity and venture capital created by bank section (either directly or through dedicated IMDs) between 2007 and 2011

Type of intervention	**Amount**	**No.**
Expansion	46%	49%
Buy out	40%	29%
Replacement	6%	6%
Early stage	7%	14%
Turnaround	1%	2%
Total	*100%*	*100%*

Source: AIFI-PricewaterhouseCoopers

Over the past years, it was also made buy outs, representing 30% of the number of operations. At the same time period, it was also shown some interest in investing in start up and in early stages of company's development, so that the major banking groups have also supported initiatives to promote enterprise creation, as a driving force for scouting activity to be made in the territory.
If one looks at the geographical distribution, the inequality affecting the activities of venture capital in Northern-Central and Southern Italy is also reflected in the banking sector commitment, so that the interventions made in the last five years have focused over the 90% in the in Northern and Central regions. Available data also reflect the lack of local banks in the South of Italy specialized in this type of intervention.
Finally, we mention the possible effect on the market of a recent change in regulatory activities pertaining the acquisition of equity held by banks.
The Bank of Italy has, in fact, published on December 12, 2011, with the 9th update of Circular no. 263 of December 27, 2006, the new supervisory regulations on equity held by banks and banking groups, contained in Title V, Chapter 4.
The new regulations, that will come into force on June 30, 2012, provides specific limits on qualifying equity in unlisted companies as well as for indirect investments by a bank in companies through, for example, private equity funds.
This discipline, on the one hand, overcomes the separation limit, previously set at 15%, according to which no bank could take a stake greater than 15% of the share capital with

voting rights in a non-financial corporation. Therefore, it is admitted the role that the bank operator can also play in the control and management of investee companies[6].

The recent Measure also introduces, for the first time, a discipline for investment of indirect holdings in equity. The general *ratio* underlying the Ruling means that, for sound and prudent management, it is defined more stringent and prudential capital absorption criteria in the case of investment through vehicles or bodies interposed between the bank and the target company (such as , the private equity funds) where the bank has no direct knowledge of strategy and operating procedures, compared to the case of investment in vehicles for which operational goals and intervention are known. Therefore, it seeks to discourage, for banks and banking groups, phenomena of "stock picking" on a variety of private equity funds.

With the passing of time, the impacts of this discipline on the future market evolution will have to be assessed.

It is not certain that the new provisions will lead to the internalisation of investment activity held by the bank through funds; on the other hand, there might be an impact on the closed-end funds subscription by banks, whose effects on the collection of private equity market will have to be monitored over time.

Together with the considerations set out, the new scenarios will also depend on the rules on the treatment of private equity exposures in terms of capital requirements for banks, contained in Basel 3, which will affect the strategic and allocative choices of banks.

As category of use, in fact, investment in private equity funds is particularly penalized in terms of application of prudential criteria and diversification coefficients of risk.
In the changing financial scenario, in which supply of ordinary credit and finance in support of acquisitions are shrinking, it will be also assessed the impact of prudential and supervisory rules on the bank operators.

3 MAIN TRENDS OF ITALIAN PRIVATE EQUITY AND VENTURE CAPITAL IN THE LIGHT OF THE FINANCIAL CRISIS

The effects of evolutive trends in existence, linked to the international financial markets crisis, have affected even the Italian private equity and venture capital.

[6] Therefore, it must be respected two investment limits for the recruitment of qualifying holdings in non-financial companies, such as the "concentration" limit, according to which these investments can not exceed 15% of regulatory capital, and the "overall" limit, which provides that it can not be exceeded 60% of the regulatory capital owned by the banking group and individual banks not belonging to a banking group. Among other things it is specified, Section VIII, detailed rules that apply to cooperative banks and collective enforcement banks: the acquisition and holding of indirect *equity* investments are permitted to these persons with limited investments in categories of enterprises and economic sectors consistent with the mutual aim.

First of all, on the front of the fundraising, where for some years there is a decline in total volumes of capital flowing into our market. We have moved, in fact, from about three billion of assets gathered on 2007 to a billion on 2011[7].

Many institutional investors of all time, who have subscribed fund shares over the past years, are awaiting the outcome of the funds performance currently being closed. Regarding the fundraising composition, the Italian market, always characterized by a low presence of domestic institutional investors as a source of capital, could count up to 2008, on a good attractiveness at the international investors.

In recent years, also due to the Country risk and, therefore, the instability of economic outlooks and national policies within the euro Area, this component is greatly diminished. The fundraising difficulties are also reflected on lengthening of the time necessary for funds to achieve the established capital targets.

From 2004 to 2008, in fact, this range is increased by over 60%, reaching, on 2008, 15 months. Even in recent years, the time interval has continued to grow, reaching the threshold of 18 months, on average, at the international level (Preqin 2012).

As concerns the investments, after years of growth, the Italian private equity and venture capital market, between 2009 and 2010, felt the effects of international financial crisis, which resulted in an economic slowdown.

Therefore, the situation changed from 5,4 billion euros invested on 2008 to 2,4 on 2010. On 2011, the business showed some signs of recovery, reaching 3,5 billion euros of loans.

On the other hand, the financial crisis has also changed the paradigms and intervention approaches.

The contraction in availability of leverage and its granting at a higher cost for acquisition operations has meant that operations were carried out with a more moderate use of leverage or equity only.

On 2011 the net debt paid, on average, was equal to 2,5 times the Ebitda of the target company, reconfirming below pre-crisis period (4,8x on 2006)[8].

Although the use of leverage in Italy has been lower at international average levels, the international market, in the crisis years, however, levelled off to more physiological values of debt (Bracchi, Del Giudice 2009); therefore, the strategy of value creation by private equity

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[7] Unless otherwise specified, in the section we will use statistical analysis prepared by AIFI and PricewaterhouseCoopers annually on the progress of the Italian private equity and venture capital. For the complete set of data, please visit the website www.aifi.it.

[8] For more details, please see the annual reports published by the Private Equity Monitor® of Carlo Cattaneo University on the website www.privateequitymonitor.it.

and venture capital operators focused on operating leverage rather than on financial leverage. In other words, as many have mentioned, investors have returned to deal with the "core" businesses.

The improvement of this investment is then refocused on build up and internationalization strategies, on know-how and specific skills of the investors in venture capital, which, through contacts and experience can support the company in its growth process even in the changed competitive scenario.

In general, from the sectoral interest point of view, private equity managers have been repositioned toward tendentially acyclic sections and, therefore, affected to a lesser extent the effects of the economic crisis, such as medical, utilities, food and telecommunications.

Regarding the number of interventions, this did not deviate much in recent years compared to pre-crisis levels. On average it was about 300 transactions per year. This shows that the liquidity crisis has generated a reduction in the average size of transactions, with a simultaneous increase in attention towards the mid-market companies (Bracchi 2011).

Concerning the distribution of investments, although the buyout continue to attract the most significant amount of resources (amounting to 63% of total on 2011), the expansion operations remain the most numerous, although with smaller average size than in the past: on 2011 the average cut of the latter type of intervention was 4,9 million euros, against 7,7 on 2007.

The turnaround investment deserves a separate discussion.

Turnaround means a very broad concept, ranging from operations on businesses that do not maximize their profitability to those in default. This type of interventions in Italy remains very low, despite the effects of the financial crisis on the productive fabric of the Country are now evident.

If you look at the number of operations, these were, at most, a dozen per year in recent years. The success difficulties of this type of interventions can be linked to issues related to raising capital, which, in turn, derive from the lack of managerial skills and specific track record on the turnaround. Thus, there are still considerable potentials for growth in the segment, in order to meet a sharp increase in demand by a growing number of companies that have entered or are entering a crisis that can hardly stave off without strong intervention of restructuring.

The other segment of investment, very specifically, is in venture capital or early stage interventions that support the creation of new ventures.

Although the segment has been characterized, in recent years, by more turmoil, having seen the birth of new skilled operators, the numbers of the Italian market are still insignificant when compared with other European markets.

On 2011 there only were about a hundred operations for about 80 million euros of the total amount invested.

It is hoped that some institutional initiatives undertaken in recent months may give a boost to this segment of the market, as occurred in some successful international experiences. It is legislative proposals under discussion, which aim to introduce incentives to encourage investment in new innovative companies by the various players in the sector (incubators, business angels and venture capitalists), as well as for a tax incentive, already approved and being implemented, for investors in venture capital (Article 31 of Decree Law 98/2011).

Important changes in the market have also affected the opportunities for disinvestment of equity in the portfolios of private equity and venture capital operators. The crisis has certainly made it more difficult the exit from the company and resulted in a lengthening of the holding period, i.e. the average period of detention of holding, which is extending from 3/4 to 5/6 years.

Among the disinvestment channels, awaiting for revitalization of the IPO, the investment sale to industrial buyers prevails. However, the managers still have to face a degree of difficulty of factoring portfolio, due to problems linked to this competitive context. Under these changed market scenario, also the effects of the new EU legislative framework on alternative funds (*Alternative Investments Fund Managers Directive*)will have to be evaluated in the coming years, as it must be transposed by Member Countries in the next year (Bracchi, 2012).

4 EMPIRICAL ANALYSIS: TARGETS AND ADOPTED METHODOLOGY

The final empirical analysis relates to those intermediaries bank that assume the identity of local banks since the literature review revealed the importance of territorial dimension expressed as concentration of firms specialized in high technological sectors and with a strong potential for innovation.

Other important features of technological districts, which may explain the decision to restrict the attention exclusively on this class of intermediary, were geographical proximity, relational proximity and the consultancy content of financial services to support their growth.

The analysis was carried out on local banks operating in leader regions of private equity section and, furthermore, accommodating those technological districts that despite their young age (on average all the technological districts were formed in the years between 2000 and 2003), differ from others for their dynamism in terms of successful initiatives already implemented.

Much attention was placed on those regions: Piedmont, Veneto, Lombardy and Emilia Romagna (having respectively districts with the following specializations: wireless technologies, nanotechnology, biotechnology and advanced mechanics).

In fact, in particular the Northern regions of Italy, Lombardy, Emilia Romagna, Veneto and Piedmont[9] show the largest number of private equity transactions and, furthermore, are also characterized by successful cases of technological districts in terms of industrial policy for innovation.

Immediately following those regions, there are some regions of Central Italy (Lazio and Tuscany in particular).

On the contrary, the South of Italy has been marked by a low concentration of private equity transactions in recent years; the Basilicata and Molise regions, for example, have been characterized by a complete lack those financial transactions in the considered period (a very similar behaviour for Abruzzo and Calabria regions).

The region with the largest number of investments and which enjoys an absolute leadership position in Italy is Lombardy which, with 177 investments, was characterized by a concentration on average of 37% of the total transactions made in the considered five years.

Afterwards, Emilia Romagna with 65 operations, Veneto with 52, Piedmont with 50, Lazio with 36 and finally Tuscany with 33.

[9] "Two facilities specialized in venture capital operate in this region: Finanziaria Piemontech and Fondo Innogest Capital "

TABLE 3 - THE MARKET OF PRIVATE EQUITY IN ITALY

Regions	2006	2007	2008	2009	2010
Abruzzo	0%	0%	1%	0%	0%
Basilicata	0%	0%	0%	0%	0%
Campania	4%	2%	1%	4%	4%
Emilia Romagna	17%	15%	12%	10%	10%
Friuli Venezia Giulia	4%	1%	3%	0%	3%
Lazio	7%	9%	8%	6%	7%
Liguria	3%	0%	3%	4%	3%
Lombardy	32%	36%	39%	35%	41%
Marche	2%	2%	2%	2%	3%
Piedmont	10%	12%	9%	8%	13%
Puglia	1%	2%	2%	0%	0%
Sicily	0%	1%	1%	0%	0%
Tuscany	6%	8%	8%	8%	4%
Trentino	1%	0%	0%	4%	0%
Umbria	0%	2%	2%	2%	1%
Veneto	12%	12%	8%	14%	9%
Calabria	0%	1%	0%	0%	0%
Molise	0%	0%	0%	0%	0%
Sardinia	0%	0%	1%	4%	0%
Italy	100%	100%	100%	100%	100%

Source: based on Observatory-Private Equity Monitor (PEM)

The sample consists of 71 local banks distributed as follows: 30 in Lombardy, 22 in Veneto, 12 in Emilia Romagna and 7 in Piedmont.

This sample was constructed by using two criteria: the registered office of each local bank and the number of branches.

In this way we were able to identify the territory where each local bank mainly operates.

Within the sample of 355 observations, the Lombardy region is marked by the largest number of cooperative banks and popular banks (in relative terms, this increased presence of banks in Lombardy is equal to 42% of all observations sampled and in absolute terms to 150 observations).

As concerns the size of the banking system composed of cooperative banks and popular banks, in second position after Lombardy there is Veneto region with an increasing presence of local banks (in relative terms, equal to 31% of all observations sampled and in absolute

terms to 110 observations) and then Emilia Romagna region (which contains 17% of observations sampled, being part of our dataset, that is in absolute terms 60 observations).
Piedmont Region is characterized by a lower number of cooperative banks and popular banks (only 10% of the sampled banks gravitate to this area and in absolute terms only 35 observations involving banks operating in this territory).

Table 4- Sample Structure

Region	Absolute Frequency	Relative Frequency	Cumulative Frequency
Emilia Romagna	60	16,90	16,90
Lombardy	150	42,25	59,15
Piedmont	35	9,86	69,01
Veneto	110	30,99	100,00
Total	**355**	**100,00**	

The financial sector placed under observation is the merchant banking since it contains within the private equity transactions.
In order to monitor the dissemination level of this financial sector in local banks efficiency, we have estimated a panel model.
We have chosen to estimate a panel model rather than, for example, a simple linear regression model because we have monitored different observation units (i.e. 71 different local banks) in different time instants.
Then we have chosen to estimate a panel model with fixed effects, since the main target is not to determine whether there are significant differences in the approach to advanced financial services among each banks but if there are discrepancies between regions investigated in offering these advanced financial services.
Any differences between local banks for management of these advanced financial services caused, for example, by the quality of bank management, the presence/absence of a skills portfolio that Forestieri (2007) distinguished between basic technical skills (fiscal, legal, contractarian, technological, specialized industrial) internalizable basic technical skills (general industrial, macroeconomical, financial, accounting, mathematical-statistical, informatic and legal), experience-related skills, relational skills and finally managerial skills.

Since we have no proxy to monitor each of these skills we decided to treat the quality of bank management and each of these skills as the individual effects, constant and unknown (a_i), of a generic panel model with fixed effects.

These individual effects represent the intercept of a panel model with fixed effects and vary from one observation to another:

$$y_{it}=a_i+x'_{it}\beta + \varepsilon_{it}$$

With reference to this empirical analysis, *ai*s vary for each of 71 banks forming part of the sample and enclose information that can not be observed and that uniquely identify each of these banks.

Therefore, these individual effects can not be considered as random variables that is the result of a random extraction from some underlying population.

The lack of information on these intangible assets of supply model of local banks is solved by using a fixed effects estimator (or *within* estimator) because this estimator can be obtained by estimating a regression in which for each variable we consider the deviations from the corresponding individual average.

Through this preliminary transformation of the variables (both the dependent and explanatory variables), the individual effects a_i are eliminated:

$$y_{it}-y^{-}_{i}=(x_{it}-x^{-}_{i})'\beta + (\varepsilon_{it}-\varepsilon^{-}_{i})$$

The OLS estimator obtained on each of the coefficients of the transformed panel model is often called the within estimator or fixed effects estimator and formally it assumes the following expression:

$$\mathbf{\beta_{FE}}=[\sum_{i=1}^{N}\sum_{t=1}^{T}(x_{it}-x_i^{-})(x_{it}-x_i^{-})']^{-1}\sum_{\mathbf{i=1}}^{N}\sum_{t=1}^{T}(x_{it}-x_i^{-})(y_{it}-y_i^{-})$$

Basically, we have chosen to estimate a panel model with fixed effects rather than a panel model with random effects, because this empirical analysis does not explain the differences between each sampled bank and then because, for example, the individual bank average x (i.e. y^{-}_{x}) differs from the individual bank average j (i.e. y^{-}_{j}) but attention is focused on the differences within each local bank (or within differences) and so because y_{it} differs from y^{-}_{i}.

In this way we tried to give an economic interpretation, for example, of differences between the average variables of local banks operating in Emilia Romagna compared to average variables of local banks operating in the other investigated regions.

This model aims to estimate the relationship between a dependent variable indicative of the profitability of local banks and independent variables constructed through the separation of ***net income-services*** using the information contained in bank balance sheets and especially in the related additional notes.

In the next section we will describe the nature of the variables (both dependent and explanatory) that we have chosen in order to meet the aims of this empirical analysis.

Therefore, all the explanatory variables of the model are expressed as a percentage of the aggregate economy.

4.1 MODEL VARIABLES

Although aware of these information gaps, formally the estimated panel model was designed as follows**:**

$$\text{Profitability} = ß_{1i} + \sum_{i=1}^{4} \beta_i * \text{Regio} + \varepsilon_{it}$$

In a more extended form:

$$\text{Profitability} = ß_{1i} + \beta_1 \sum_{i=1}^{77} \sum_{t=2006}^{2010} \text{TDRSit} * \text{Regio} + \beta_2 \sum_{i=1}^{77} \sum_{t=2006}^{2010} \text{TCRSit} * \text{Regio} + \beta_3 \sum_{i=1}^{77} \sum_{t=2006}^{2010} \text{CFRSit} * \text{Regio} + \beta_4 \sum_{i=1}^{77} \sum_{t=2006}^{2010} \text{DRSit} * \text{Regio} + e_{it}$$

In the estimated panel model the dependent variable, indicative of the banks' profitability, is constructed as the ratio between two aggregates of income: interest margin and earning margin..

The numerator of this ratio is the result of primary operativity of banks from the typical brokerage activity thanks to which the bank carries out financial resources collection and at the same time their transfer by making a transformation of the different risk profiles

The denominator is, instead, the result of management services that are not characteristic of the bank that includes the components of profits and losses from financial transactions (resulting from buying and selling of securities of the bank's portfolio)and net revenues of commissions management linked to provision of services (payment transactions and securities brokerage).

Therefore, this ratio provides guidance in respect to the degree of disintermediation of the sampled banks, i.e. how much of the wealth produced by the bank should be associated with the collection and loans (traditional banking activity) rather than collateral management. At constant interest margin, higher values of this quotient denote a lower capacity by the intermediary bank to generate gross profitability in addition to that coming from the traditional credit intermediation

The table below shows the explanatory variables of the panel model estimated, their formalization and analytical information extracted from the notes used in their construction.

TABLE 5 - EXPLANATORY VARIABLES MODEL PANEL

Type of Operation Merchant Banking	**proxy variable**	**Analytical expression (% Revenues from Services)**	**Sections of the Notes**
Operations Funding	TDRS	Debt/Services income	Item 80 - Section 4
Acquisition of investments	TCRS	Equities/Services income	Item 80 - Section 4
Financial covenants	CFRS	Commercial guarantees/Services income	Other Information-commercial guarantees
Dividends	DFRS	Dividends/Services income	Item 70 - Section 3

Sources: our processing

The first variable (**TDRS**) [10] provides information on the contribution within revenues from services in the buying bonds business.

In particular, the dynamics of this variable may provide some indications on the spread of financing operations, which represent a mode of expression of *merchant banking*.

Typically, these operations are, in fact, made by the merchant bank, in the technical form of subscription of convertible or non-convertible bonds.

The second variable (**TCRS**) provides information on the incidence of the average percentage of financial assets available for sale relating to equity securities as part of the economic aggregate components revenues from services; in other words, this variable can provide guidance on the intensity of another way thanks to which it is possible to carry out the *merchant banking*, i.e. the acquisition of shareholdings in social capital of the financed companies.

The third variable (**CFRS**)[11] provides information on the average percentage incidence of commissions generated from cash loans on net revenues by services and in particular on the local banks' use of financial *covenants* i.e. clauses that guarantee the right of shares redemption in the event of failure to achieve the set economic-financial parameters. The last variable (DFRS)[12] provides a measurement of the average percentage incidence of financial assets and in particular of the shareholdings of corporate customers in the form of dividends.

These explanatory variables were added with regional dummies (Royal), which were crossed with each of the explanatory variables (and which identify whether local banks operate primarily in one of four attentionated regions)

4.2 RESULTS: AN ECONOMIC INTERPRETATION[13]

The *dataset* consists of 1155 observations as we have monitored 5 variables for each of the three-years period (2006-2010) and for each of the 77 sampled banks

The possible relationship between each explanatory variable and each dependent variable was annotated using both a statistical and economic interpretation.

With reference to the first interpretation, we used three basic criteria: the standard error associated with each estimated ß coefficients, the values of the Student t-statistics and p-value (arbitrarily set equal to 5%).

Taking a probabilistic reasoning (i.e. using the p-value criterion), with reference to the first variable (TDRS), inhomogeneities within the Sample emerge; in fact, with the exception of the Emilia Romagna and Lombardy banks, all other banks have not relied on sales of debt securities to raise their levels of economic performance.

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[10] "Both for debt and equity securities Item 80 - Section 4 of the Additional Note"
[11] "Additional Note-Other Info- Commercial guarantees"
[12] "Item 70- Section 3 of the Additional Note"
[13] "The **Output 1** below contains the results obtained from the estimation of this model"

At a confidence level α amounting to 5%, the coefficients estimated for this first explanatory variable are significantly different from zero only for local banks operating in these two regions.

Observing the standard error which express a measurement of the internal variability of local banks samples subdivided per region, they are lower for Emilia Romagna and Lombardy banks than the half of the estimated coefficients, leading then to statistical *t-Student* values (respectively equal to -2,16 and -3,89) higher than the critical value (equal to 1,984) of the probability distribution below (i.e. this statistics fall in the region of the null hypothesis rejection).

Therefore, financial assets available for sale in the form of financing transactions in the merchant banking sector have exerted their significant contribution to economic performance of banks located in these two regions.

Regarding the results obtained for the second variable (TCRS) for Lombardy and Piedmont local banks, capital securities were an important determinant within the aggregate net income from financial services, which indicates that these banks pay a greater attention to the profitability of services management (i.e. the components of gross income) rather than that of money management (i.e. the components of net interest income).

In particular, it is cooperative and popular banks in Lombardy and Piedmont to be united by an average quotient equity /Services income in the considered three year period particularly significant in their Financial Statements.

The p-value associated with the estimated beta coefficients are lower compared to a confidence level α amounting to 5%, thus prompting to reject the null hypothesis of significance abscence of the estimates obtained.

The standard error associated with these estimates are less than half of the estimated coefficients thus determining values of *Student's t* that are larger than their critical value of the above probability distribution (equal to 1,984) and then they fall in the null hypothesis rejection H_0 (respectively equal to 2.07 per local banks of Lombardy and 4.01 for local banks of Piedmont).

For all banks located in other regions, equity securities and then acquisition of equity interest in the target company have not formed an important determinant within the aggregate economic of net revenues from services which indicates a greater attention by these banks to profitability of money management (i.e. the components of net interest income) rather than the management services.

Regarding the third set of variables (CFRS), which provides information on the average percentage incidence of commissions generated by the credit commitments of net revenues from services, we noted the following behaviours among observed banks of the sample: in all regions placed under observation, the local banks have in common variable values not close to zero thus indicating the presence of a significant contribution to the dynamics of economic aggregates, indicative of banks capacity to implement strategies of supply diversification (i.e. earning margin and services revenues).

All p-values associated with the estimated coefficients for each of the explanatory variables of the model are lower at the level of confidence of 5% ά leading to confirm the relevance of these variables on the earning capacity of local banks in all four regions surveyed. The standard errors are all smaller than half of the relative estimated coefficients thus leading to the construction of Student's-t statistics with higher values than their critical value and then falling within the area of the probability distribution that represents the region of null hypothesis rejection (respectively 3.72 for Emilia Romagna local banks, -2.01 for Lombardy local banks, 3:44 for Piedmont local banks and - 2.34 for Veneto local banks).

In order to give even an economic explanation of these results, it is possible to affirm that local banks in the analysis sample prefer to receive these guarantees rather than resort to other protection mechanisms of investments such as the possibility to be an active part in the process of management appointment, the right to appoint one or more members of the board of directors of the subsidiary and yet the conclusion of non-eligible contractual clauses, however, as financial *covenants*.

The results for this explanatory variable confirm the conclusion reached by Baravelli (2002) in his earlier contribution with particular reference to the efficiency of Sicilian banks only for the period 1993-1998.

This author argued that the increase in bad debts during that time indicated that Sicilian local banks had accepted a high credit risk and that is why they demand greater guarantees to clients, or that had committed errors in the evaluation of credit risk, with the result that, since they did not demand adequate guarantees, they have to face large losses.

Compared to larger banks that operate in extra-regional territories, according to this author, local banks did not taken charge of high intense pricing policies and expansion of their loan portfolio to meet the external competition, but they preferred to maintain and strengthen existing relationships with their customers thus managing to preserve their market shares and reduce the damages that could be generated from an indiscriminate development activity, increasingly marked by the centrality of pricing policies and less careful to the evaluation of creditworthiness.

These results are further confirmed in a study carried out by Conca and Riccardi (2009) who tried to understand in more detail what the changes were associated with the crisis in terms of trends in the credit market, debt structure and contractual characteristics.

This research represents an investigation just referred to the Italian market, which involved the participation of 81 subjects divided among private equity funds (29), *lenders* (20), M&A operators (22) and law firms (10).

With reference to the contractual aspects of the leveraged buyout (LBO), the view emerging from this survey is that the *credit crunch* is causing a tightening of *covenants* within the contract.

Covenants "light" in the past had often been requested by the *borrower* and accepted by the *lender* to close the transaction and then sell more or less rapidly the debt.

Today, however, the *lenders* are more concerned with imposing stringent terms within the contract in order to ensure greater control of any *borrower's* moments of crisis, in a market situation where, compared to the past, they are obliged to "report on their financial statement" a substantial part of the debt for longer time.

With reference to the last variable (DRS), with the exception of Lombardy banks, we found that the contribution of available financial assets and investments in the form of coupons and dividends has taken a quite residual significance among the components of the aggregate net income from services sampled local banks.

With a p-value of 5%, the estimated coefficient for this explanatory variable in the other three regions are not significantly different from zero then pointing out a little significant incidence on the profitability of local banks operating in these regions.

The standard error associated with these estimated betas coefficients are larger than half the amounts of these coefficients thus leading to the construction of lower t-Student values than their critical value and then falling in the region of the probability distribution of null hypothesis acceptance.

Besides this statistical interpretation of the results obtained from estimating the panel model with fixed effects, we also carried out an interpretation of purely economic nature relating to the management choices of local banks investigated.

Any bank that wishes to enter into this business section should be able to design a productive process decomposable into eight different stages, each of which requires activities, resources, knowledge and well-defined professional profiles:

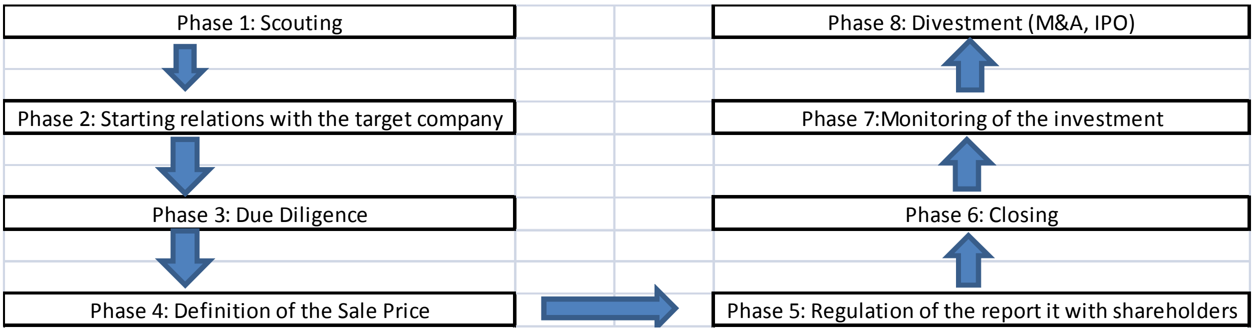


Figure 1: The production process of an intermediary in the financial sector of private equity, Capizzi(2006)

The observed heterogeneity may be explained by the fact that the sampled banks have mainly addressed the technical skills in this business section and especially in downstream stages of the production process, as part of phase 1, 3, 4, 7 and 8.

In particular, local banks, especially in the early stages of the production process, exploiting the benefits deriving from their significant local embedding could initiate some *network* of relationships with external professionals and advisors specially empowered in this financial sector so as to abandon the appearance of *retail oriented* bank and mainly addressing toward the figure of a *corporate oriented* intermediary.

In later stages, i.e. negotiation and subscription stages for investment, these banks should consolidate their knowledge on the form of contracts so as to avoid potential opportunistic behaviour by the subsidiary, efficiently allocate voting rights in the new shareholding structure and predefine means by which the *way out* will be realized.

The banks having showed significant estimates have also owned those relational skills that have taken a predominantly upstream significance of the production process, in stages 2, 5, and 6 since it is in these phases that the ability to "manage" the investment becomes critical for the intermediary, competently and diligently follow the company's progress, monitor the progress of both historical and prospective industry within which the subsidiary operates, periodically check the size of the deviations from the goals set (formalized in the *business plan*) and, finally, carefully prepare the operation that will lead to disinvestment. These local banks also own the financial skills that would make these banks suitable partner for companies that primarily represent favourable investment opportunities.

On the contrary, local banks having shown insignificant estimates are probably characterized by a major weakness in the ability to manage information and negotiate with the customer (lack of senior staff), the lack of a single, integrated view of the activities inside them, the lack of knowledge on *risk management* issues, functioning of markets and relative financial instruments, financial analysis and evaluation of investments, especially in the most innovative sectors (particularly interesting for venture capital).

In order to overcome this skills gap, local banks may resort to the *training-on-the job* for junior resources, in addition to internal and external training, without ruling out the possibility of acquiring already trained resources (especially for management levels).

The training initiatives aimed at acquiring the basic technical skills to operate in this business section resort to long *under-graduate* and *graduate* programs, both to short programs with executive and specialized cut.

Another strategy that local banks could adopt in order to address this skills gap may be the *turnover* that allows them to recover resources having gained experience in operations areas of the bank significantly different from those being studied (for example, overdraft section, securities section, *retail* section).

These banks will have to acquire increasingly more specialized professional backgrounds and will be able to coordinate the multiplicity of these internal organizational roles and the areas of responsibility in order to successfully operate even in the financial sector of *merchant banking* and *private equity* in particular.

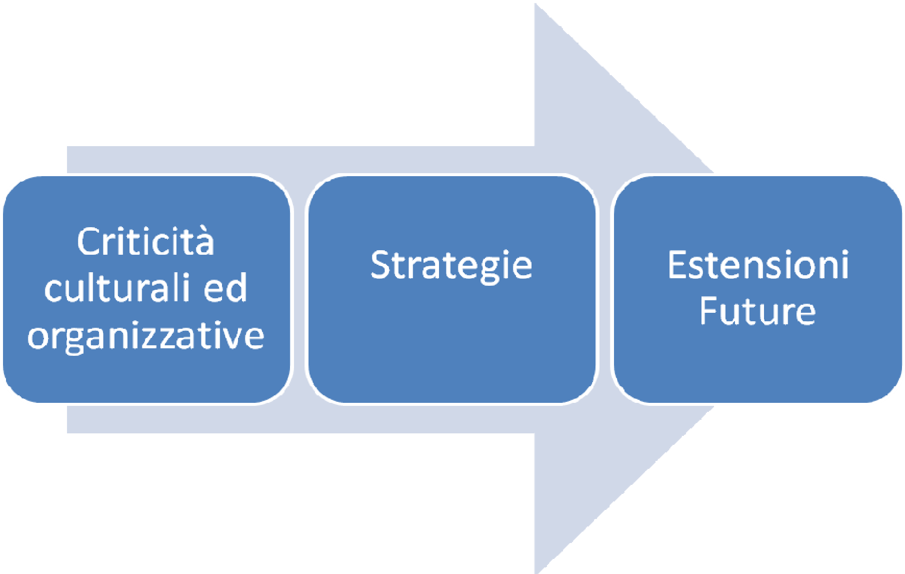
Therefore, in this respect, it is also crucially important to the ability of overall vision and management of the complexity held by the figures of *client manager*, *category manager* and *professional*[14].

The sampled banks that actually appears to be lacking the characteristics to successfully operate in the financial *merchant banking* and *private equity* in particular should also make interventions to promote the ability to work in team, make the organizational structure leaner and especially make the costs structure more flexible since the economic returns of *merchant banking,* i.e. dividends and capital gains on disposals are marked by some uncertainty both with regard to the amounts and the time profile of the event.

14" For a description of the functions of these three professional roles, please refer to Baravelli's reading (2003)".

5 FINAL CONSIDERATIONS: LOCAL BANKS' CULTURAL AND ORGANIZATIONAL CHALLENGES FOR DEVELOPMENT OF PRIVATE EQUITY IN SUPPORT OF SMES:

The conclusions of this paper can be summarized in three main component shown in the figure below:



The empirical analysis showed that local banks operating in the regions of technological districts are still far from the acquisition of a form of multi-product, multi-market, multi-technology and multi-sector firms.

In other words, local banks can not be configured as an ***multispecialist*** *i*ntermediary bank i.e. able to coordinate many activities by adopting a division and specialization logic of activities and also ***multibusiness*** ones, able to ensure a greater correlation between the various strategic business areas (ASA).

In recent years, it was defined a new economic situation that necessitates a review of how to conceive the system of relations between banks and companies, including when the intermediary banks assume the role of local banks.

The two main events were the introduction of new financial rules known to all as Basel 2 and the spread of a global financial crisis.

These two events led to the following major changes in bank-company relationship:

1) The management of bank credit has left the traditional financial sector of commercial banking and has increasingly characterized the financial sector of market finance (i.e. the *corporate banking*) ensuring a greater transparency and consistency with the risk profile of the counterparty;

2) The credit products are calibrated and specialized on individual components of credit risk (PD and LGD);

3) The intermediary banks have increased their ability to diagnose and analyze the creditworthiness of companies, identifying with a certain speed any signs of structural weakness of companies. Especially small and medium-sized ones, previously weakened by the absence of non-systematic and rigorous assessment methods;

4) The statistical methods used to estimate the credit risk use as a main variable the working capital and this causes many difficulties to those *retail* businesses that fail to have a clear perception and control of their assets;

5) The bank's evaluation paradigms change as the analysis of credit risk moves from a diagnostic approach based on the budget on the capacity of guarantees for an approach based on business plan and perspective ability to generate future cash flows.

These aspects should be compared with the specifications of the client companies to understand the impact on the economy system as a whole.

First, the financial management has little relevance compared to the management of productive and business activity that acquires a reference central role in the life cycle of the entire company's system.

Therefore, the financial management assumes the role of exclusive management of relationship with the banks and with the system of deferred payments within the customer-supplier circuit.

Furthermore, the relationship between the shareholder and company's assets becomes one influencing the formation of the financial needs of the latter.

For this reason, the demand for financial services is more strongly driven by the optimization need of capital and asset flows between family and company rather than by needs strictly related to the company's dynamics.

Finally, it should be noted, as it was shown in the results of empirical analysis proposed in this paper, that some financial services (such as financial counselling) are not structurally consistent with the needs of smaller retail companies, and that determines a simplification and a standardization of bank-company relationship.

Together with these specificities of company's system in Italy there are a number of structural factors such as:

1) a structural presence of an asymmetric fiscal lever on the tax cost of capital, which constantly encourages the use of debt capital at the expense of a proper planning of the company's capitalization;

2) the presence of a very wide number of companies, while excellent, however, that stabilizes its own growth path on a micro-sized or small, physiological and definitive dimension.

In light of these changes affecting the banking operations and the nature of the Italian business system, the new role that the banking system can play in promoting the growth of companies require many significant challenges whose combination will be a responsible choice of each bank, local or national, to define its own competitive positioning on the market and the resulting organizational model.

A first challenge is the size: the size is necessary for efficiency, but the future challenge will be to ensure an expansion of services consistent with the characteristics of demand and in respect of the protection and the enhancement of the distinctive characteristics of a local bank.

A second challenge is the network: the smaller banks will have to define the mode (aggregation, delivery) so that the small size does not represent an obstacle to the diversification of the supply portfolio so the ability to support companies.

The third challenge, the professional relationship, emphasizes, instead, the need for a distinction between the culture of "professional relationship" (based on the technical content of the supply solutions) and the culture of "spontaneous relationship" (based on the ability of listening and interacting with the customer).

The banks will have to acquire information from the world of business and use that information disseminated mainly at central and peripheral level in knowledge and skills expendable and usable for companies' service.

This means moving the concept of information from a *people specific* valence (where information are people's assets and not bank's assets) to a *firm-specific* valence (which makes information on customers an organization's heritage).

The fourth challenge for internationalization emphasizes, instead, the role of banks as a necessary infrastructure for development abroad, so the presidium of the distinctive techniques for internationalization of companies, especially the small ones, becomes a clear factor of competitive advantage creation .

The fifth challenge for assessment involves the ability to mediate and synthesize among very different instances that converge on the evaluation process of the counterparties. The banks will have to reach an effective combination between rigour and needs of objective measures required by a risk management system and the presence of medium-term relations and confidential information that emerge in the same relation with the companies. This does not mean lowering the rigour and the objectivity of judgment on the creditworthiness of the counterparty retail but integrating information hardly catalogable and censible in an objective context.

The organizational aspects can be conceived as a strategic variable on which banks must confront in order to compete successfully in the *corporate* and *investment banking* sectors; in fact, the ability to establish relationships of trust hinting at solid cash flow prospects over the medium/long-term falls more and more among the factors at the basis of their competitive advantage.

In this sense, local banks are more advanced than other types of banks since they can leverage their strengths linked to the territorial vocation of their strategic choices focusing on the philosophy of *relationship lending*.

Yet the presence of a quite diffused network of branches in the territory is not enough to make successful strategies of operativites differentiation of these banks.

The transition from one organizational functional structure to a divisional one would represent the ideal solution for this change.

The adoption of a divisional organizational structure leads banks to rethink their policy of diversification and segmentation as well as modes for distribution and customer contact. However, the realization of a *business unit* focused on the *corporate* demand segment is not an immediate phase for this type of banks; in fact, the transformation of these banks identity in global financial partners of companies needs specific skills not only relational but especially technical, financial, fiscal, industrial/sectoral, with planning and strategic control.

All explanatory variables of the panel model estimated were significant only in the Lombardy region while greater heterogeneity involved the other three regions investigated. This remark indicates, in our view, that local banks operating in Lombardy can be held for eligible financial partener of small and medium-sized enterprises located in the territory of this region and are therefore able to diversify their supply model working in the private market equity.

On the contrary all banks operating in other regions investigated have not been able to support all of their inherent ability to build customer loyalty as many financial skills, managerial and industrial services necessary for the implementation of merchant banking.

Probably, these banks still adopt a logic of granting credit based on insurance that has as main consequence a high diversification risk (obtained through a consistent fractionation) rather than an operativity focused on relationship value.

A greater preference for long-term relationships with customers, will lead local banks to assess the credit risk of customers no longer by choosing a static analysis but evaluating the goodness of entrepreneurial projects.

Another *forma mentis* that local banks will have to acquire in order to diversify their supply system toward the *corporate* and *investment banking* services is the evaluation of the profitability of relationships with customer over time (relationship-oriented approach) and not the individual transaction (*transaction-oriented* approach).

The adoption of this new approach should induce banks to support the customer even in situations of financial difficulty, convinced of a recovery in the medium/long term. Another shortcoming of local banks is the lack within their organizational structure of an important professional role for the *corporate banker* (*account manager* or *client manager*).

Probably, these banks have tried to replace this profile with other organizational figures such as credit analyst, or the branch manager[15].

Unlike these two professional roles, the *corporate banker* has a financial, commercial and relational structured cognitive heritage that allows him to fulfil the function of connecting link between the credit and commercial divisions.

The complexity of this heritage can be traced to the fact that this organizational role is responsible for a variety of tasks such as evaluation of company's potential and acquisition of the relationship, assessment of creditworthiness, definition of financial and credit assistance, price management and relationship monitoring.

The *corporate banker* is able to exploit for commercial purposes the information gained in analyzing the financial risks of the company and vice versa using the information collected for commercial purposes within the assessment of creditworthiness so as to detect in advance any impact of the company.

At the same time, he is able to improve all possible informative synergies with other distribution channels or product units belonging to the bank.

With reference to the assistance service, its complexity may cause an excessive load on the sole *corporate banker* who, consequently, requires a team of internal specialists (financial analysts and product specialists/consultants) more suitable in the different services offered (financial risk hedging, financial securities, corporate finance, structured finance). The absence of these specialists within the local banks operating in the areas of technological districts may provide an explanation of the quite marginal values of the budget item "net fees for consulting services", highlighting the total inability of banks to operate in the *corporate finance* and then to create coordination forms within work teams placing as an interface between the bank organization and the customer.

15"Baravelli (2002)".

Another possible explanation of the low uptake of advanced financial services of *corporate banking* within the supply system of local banks sampled may be related to the finding that in these banks the organizational figure of *corporate banker* have dominated as global consultant for SMEs with limited financial needs rather than a "facilitator" *corporate banker* able to promote within the bank the value of relationships with customer (i.e. the consultant does not simply sell the bank to the customer but the customer to the bank demonstrating the profitability of the relationship over time).

In order to overcome these cultural and organizational problems by developing a greater synergy between their characteristics and the provision of services of private equity, the local banks may use the following strategies:

- funding buy-back mechanisms;
- promoting the co-investment logic;
- development of a “widespread” value chain;
- support for enhancing mechanisms.

The first strategy aims to the relevance that the companies’ capitalization took in the bank-company relationship (and therefore in the rating and on access and cost of credit) and in development of corporate finance transactions.

In particular, the use of a private equity fund operated by an enterprise, in addition to requiring overcoming of the organizational and cultural critical issues, necessarily requires the possession of specific dimensional requirements; in fact, these funds do not invest below a certain threshold of company’s sales that, conventionally, is identifiable in 20 million euros. This size difficulty could be overcome by introducing a buy back "guarantee" of the fund share by the entrepreneur or the company.

Obviously, the ability to guarantee the buy back may be strengthened by the presence of a sustained underlying funding that can be given according to the logic of direct disbursement by the banks of the territory of the indirect scheme through trust.

The spread of a co-investment logic is referred to the use of private equity as an instrument of attraction and proliferation of resources for SMEs.

The development of private equity in favour of the smaller companies can not be based only on support mechanisms related to the buy back linked to demand support, but also on support mechanisms based on the funds supply.

In this sense, one of the obstacles to investing in smaller companies is still represented by the excessive risk related to the expected return.

In this regard, a possible strategy to encourage private investors to allocate the private equity to SMEs is made by creation of joint public-private funds where, in case of loss, sharing is joint but in the case of profit, the public investor's remuneration is predetermined and, consequently, the private's one is variable.

This mechanism, known as *up slide leverage scheme*, allows private entities to co-invest (and therefore to spend less capital), bearing the losses but benefiting asymmetrically (and profitable) revenue, balancing the risk-return relationship.

In this regard, the promotion of local funds, characterized by *up slide leverage scheme* mechanism would allow to increase significantly the ability to intervene in support of smaller companies, also characterized by a crisis situation.

With reference to the strategy of creating a common value chain, the presence on the territory by the local banks can be used in a decisive manner to the approach of private equity firms to smaller firms.

This is due to two different mechanisms.

On the one hand, the knowledge of territory can contribute significantly to enhance the *origination* activities, thereby ensuring continuous cash flows in relation to SMEs. On the other hand, the entire value chain of the private equity process (*origination*, *screening*, evaluation, *due diligence*) may be largely decentralized in the territory according to a logic of co-responsibility among private equity funds and local banks both to lower their costs and to create awareness toward dimensionally small companies.

The strategy aimed at supporting enhancing mechanisms, i.e. guarantee and mitigation of credit risk, can be achieved through the trust, whose mutual spirit and whose knowledge of the territory can play an important role in overcoming the critical size.

However, the trust action must evolve from a, however precious and essential, support to ordinary loans and for equity transactions, whose main increased risk can receive as a counterweight the presence of incentives and *ad hoc* funding, from the same system of banks.

With reference to the possibly future extensions we thought the following:

1. To enlarge the sample of banks considered in order to undertake a comparative analysis of the degree of diversification of the supply model of the banks of the North, Centre and South Italy

2. To consider also other categories of intermediary bank operating in the regions investigated

3. To include explanatory variables in the model on the characteristics of regional firms (age, size (turnover, number of employees), sector specialization (Lazzeroni M., 2004), ROI and degree of financial autonomy (Source: AIDA Database)

4. To include in the model panel varibali explanatory / proxy of the intensity of bank-firm relationship obtained for example by administering a structured questionnaire to local banks sampled (supply side) and businesses specializing in science-based sectors (demand side) operating in the regions of technological districts aggregated between North, Central and South Italy (Bisoni C., 2010, Munari L., 2011)

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APPENDICE 1 - LE BANCHE LOCALI INDAGATE

Regione	Banche Locali
Piemonte	BCC Vagienna, BCC di Caraglio, BCC Casalgrasso, BCC Cherasco, BCC Pianfei, BCC del Canavese, BCC Alba
Lombardia	BCC Bergamasca, BCC Valle Seriana, BCC Basso Sebino, BCC Brescia, BCC Calcio e Covo, BCC Caravaggio, BCC Inzago, BCC Pompiano, BCC Orobica, BCC Garda, BCC Cremonese, BCC Bedizzole, BCC Agrobresciano, BCC Castel Gofredo, BCC Carate Brianza, BCC Cantù, BCC Padana, BCC Cremasca, BCC Alta Brianza, BCC Binasco, BCC Buguggiate, BCC Sesto San Giovanni, BCC Triuggio, BCC Valsabbia Paganella, BCC Adda, BCC Barlassina, BCC Sorisole, Banca Popolare di Milano, Banca Popolare di Sondrio, Banca Popolare di Valsabina
Veneto	BCC Adige Po, BCC Alta Padovana, BCC Alto Vicentino, BCC Benaco, BCC Brendola, BCC CentroMarca, BCC Cortina d'Ampezzo, BCC Veneziano, BCC Marca, BCC Monaster del Sile, BCC Marcon, BCC Prealpi, BCC Roana, BCC Romano e S. Caterina, BCC Sant'Elena, BCC Valpolicella, BCC Verona, BCC Trevigiano, BCC San Giorgio, Banca Popolare di Marostica, Banca Popolare Etica, Banca popolare di Vicenza
Emilia Romagna	BCC Reggiana, BCC Ravennate e Imolese, BCC Bologna, BCC Cavola e Sassuolo, BCC Cesena, BCC Forlì, BCC Gradara, BCC Valmarecchia, BCC Romagna Est, Banca Popolare dell'Emilia Romagna, Banca Popolare di Valconca, Banca Popolare San Felice

APPENDICE 2 – IL PRIVATE EQUITY NELLE REGIONI DEI DISTRETTI TECNOLOGICI (OUTPUT 1)

Numero di Osservazioni = 355
Banche Campionate = 71
R^2 : stimatore within= 0.3931
R^2 : stimatore between = 0.0011
R^2 stimatore OLS = 0.0674

F(16,268) =10.85 Prob > F =0.0000

REDDITIVITÀ: VARIABILE DIPENDENTE

Variabili Esplicative	ß stimati	Standard Error	t-ratio
$TDRS_{Romagna}$	-.0024776**	.0011461	-2.16
$TDRS_{Lombardia}$	-.0021535**	.0005541	-3.89
$TDRS_{Piemonte}$	.0020658	.0012354	1.67
$TDRS_{Veneto}$	.0000291	.0006221	0.05
$TCRS_{Romagna}$	-.0031443	.017865	-0.18
$TCRS_{Lombardia}$	.0327432**	.0158114	2.07
$TCRS_{Piemonte}$	.018349**	.0045764	4.01
$TCRS_{Veneto}$	.0428178	.0219142	1.95
$CFRS_{Romagna}$	.0075852**	.0020401	3.72
$CFRS_{Lombardia}$	-.0012612**	.0006273	-2.01
$CFRS_{Piemonte}$	.0286654**	.0083221	3.44
$CFRS_{Veneto}$	-.0057621**	.0024579	-2.34
$DRS_{Romagna}$	-.4008466	.5214546	-0.77
$DRS_{Lombardia}$	1.844903**	.3346828	5.51
$DRS_{Piemonte}$	-.0011445	.0023021	-0.50
DRS_{Veneto}	.5601624	.9866148	0.57
Costante	.7300348	.0078625	92.85

F(70,268) = 5.52 Prob > F = 0.0000
** risultati sono significativi ad un livello di fiducia del 5%