



# Local banks and private equity: cultural and organizational challenges in light of the international financial crisis

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## ABSTRACT

*This paper describes some of the changes that have been brought about in the Italian private equity market by the global financial crisis, by undertaking a contextual analysis of the characteristics of supply and demand in the private equity sector.*

*On the demand side, we attempt to describe the major effects of the financial crisis in terms of the trends, size, and profitability of the companies investigated.*

*On the supply side, we attempt to verify in the light of the global financial crisis whether the category of intermediary bank represented by local banks has changed its modus operandi in order to gain the characteristics of a diversified intermediary in the merchant banking business sector. We have here tried to trace the evolution of the role of the bank in dealing with private equity. In particular, we describe and empirically analyse the role of local banks in providing support for nationwide companies.<sup>1</sup>*

**Keywords:** Regional Innovation System, Technology Districts, Financial Crisis, Private Equity, Merchant Banking, Local Banks

## 1. INTRODUCTION

This paper describes the changes caused by the global financial crisis in the strategic and operational choices made by local banks embedded in territories where Italian technological districts are located, which can be described as cases in which industrial policies have successfully promoted innovation.

We chose to focus our analysis on those areas in which banks show a greater ability to diversify their model of supply and to implement a wider skills portfolio.

The *merchant banking* sector, in which we find the *private equity* operations, was monitored for the period of the entire financial crisis (from 2006 to 2010).

We first aim to provide a description of the main effects of the financial crisis on venture capital investments, and thus more generally on the Italian *private equity* market. We then try to answer to the following research questions:

*“What has been the size of the downturn of financial services and private equity revenues reported in the banks’ balance sheet, considering those banks operating in technological districts?”*

*“Are local banks able to offer advanced financial services related to private equity in support of companies operating in Italian technological districts?”*

Technology districts and regional innovation systems represent significant opportunities for local banks to change their action plans.

In this work, we attempt to investigate the role that innovative finance can play within such networks of companies specializing in highly technological sectors and tending toward innovative change.

The intangible development factors involved in technology districts, and the lack of physical assets with which to gain access to credit lines, require a transformation of the traditional sources of financing for business districts. Intangible assets involve an increase in informational asymmetries in the bank-company relationship, and therefore demand new financial techniques that can guarantee adequate coverage of the major risks. Local banks leverage their strengths using their territorial vocation and strategic choices, focused on the philosophy of relationship lending. This kind of bank could gain a distinct advantage from a reduction in informational asymmetries.

Another factor rendering the bank-company relationship less effective in technology districts is the limited appropriability of assets, which makes it difficult for companies to explain to bankers the subject of research projects for which financing is required.

Small and medium-sized enterprises thus often attempt to bypass these obstacles by resorting to their self-financing, where possible. Where this is not possible, the lack of self-financing becomes a serious constraint on the growth of small and medium-sized enterprises in technology districts.

These companies may then decide to try for venture capital, private equity, or mezzanine financing.

In order to pin down we mean by a technological district, we have chosen the definition of Bonaccorsi and Nesci (2006) *“a systemic dimension of innovation and concentration of these innovations on a territorial basis”*, as it summarizes the two lines of research characteristic of any technology district, and which have been theorized in the various contributions to the literature. These authors refer to *“basins of skills”*: these are territorial systems characterized by the coexistence of human capital with technological knowledge that can be employed in the production process by professionals possessing valuable skills of general management for coordinating inter-organizational innovation in the district.

The table below summarizes the main contributions in the literature on regional innovation systems:

Table 1 – Regional systems of innovation and technology clusters (source: our processing)

Features	Contributions
Internal factors: business leadership, their resources, and skills	Schumpeter (1934), Nelson and Winter (1982), Dosi (1998, 2000), Teece and Pisano (1994)
External factors: social dimension, territorial system, and the crucial role of learning processes	Lundvall (1992, 2002), Nelson (1993), Cooke (1997, 1998), Malerba (2000), Crespi and Pianta (2007)
Role of institutions	Edquist(1997), Nelson and Rosenberg(1993), Andersson and Karlsson(2004), Asheim and Isaksen(1997; 2002)
Internal and external factors	Malerba(2000), Krugman (1991, 1998), Marshall (1920), Becattini(1979, 1989, 2000, 2002), Bellandi (1982, 2003), Brusco and Paba(1997)
Governance models of technology transfer processes	Braczyk, Cooke and Heidenreich (1998)

This paper consists of three main sections. In the first section, an analysis is shown of the evolution of the mode of action of bank intermediaries, and especially local banks, in *private equity* in support of nationwide companies, with particular reference to both regulation aspects and the nature and size of the investments made by these banks in this business area.

The final section contains an empirical analysis that, using the econometric methodology of a fixed-effects panel estimator, attempts to check whether the advanced financial services within the *merchant banking* area are indeed a highly distinctive element in the supply model of local banks operating in the regions of the Italian technological districts.

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

This section 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 applicable regulations and legislation have affected the role of the credit institution in venture capital market. In Italy, the CICR Resolution, and the related circular issued by the Bank of Italy in 1987, which enabled banks to invest in venture capital from industrial enterprises. This could only be done indirectly, through financial intermediary entities having direct representatives—the so-called merchant banks.

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 hold direct investments in nonfinancial companies.

Furthermore, 1993 was also the year of the birth of the closed-end investment fund legislation (Law no. 344, August 14, 1993 Gervasoni, Bechi 2007).

Several banks began to promote, through specialized Investment Management Companies, investment in companies’ risk capital, making closed-end fund shares available to their customers.

Somehow, the banks were acting as a driving force for investment in risk capital, in terms of direct intervention, as well as through the creation of specialized divisions, and by promoting investment through the creation of the first closed-end funds intended for retail customers (Bracchi & Bechi 2005).

After 2000, the number of banking divisions compared with the total number of operators has begun to decline, due to the creation of closed-end funds to enact the same reference credit groups.

Recently, this trend was also interrupted on account of a reduction in the number of IMCs promoted by the banking sector, and by the growing importance of independent operators (Bank of Italy 2009).

As regards the specific role played by local banks—differing in structure, reference standards, and operating procedures from other credit institutions—the importance of private equity to 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, embedded in the territory, result from both a social structure that is an expression of the reference context and from the collection of savings, which supports and funds the real local economic development and facilitates the connection with enterprises, as well as the ability to understand and accommodate in a timely manner the growth needs expressed by the companies operating there.

Among the features of the *modus operandi* of these banks are reciprocal control and so-called *peer monitoring*.

This is expressed in the local community and provides an incentive not to engage in opportunistic behaviour, in order to avoid social sanction.

This leads to long-term interaction between the partners (customers) and the local mutual bank, which in Italy is typically represented by the Cooperative Credit Bank (Azzi & Bracchi 2005).

We now move from the analysis of the number and type of operators to an examination of investing in private equity and venture capital. We employ data collected annually in the survey by AIFI (the Italian Association of Private Equity and Venture Capital), in collaboration with PricewaterhouseCoopers. It can be noted that in the last five years there has been a significant decrease in investments made by banks (considering both direct investments and those made by IMCs in banking groups). In fact, this trend is justified, among other possible explanations of the phenomenon, by the view that banks (including local banks) participate in ever-increasing private equity activity as investors in funds, placing this role instead of to that of promoter of investment vehicles, or even direct investor.

Finally, we mention the possible effect on the market of a recent change in regulatory activities pertaining to the acquisition of equity held by banks.

On December 12, 2011, the Bank of Italy in fact published, as part of the ninth update of its Circular no. 263 of December 27, 2006, new supervisory regulations on equity held by banks and banking groups, contained in Title V, Chapter 4. The recent Measure also introduces, for the first time, a discipline for investment of indirect holdings in equity.

The general reason underlying the ruling is that, in order to encourage sound management, more stringent and prudential capital absorption criteria are needed in the case of investment through vehicles or bodies intermediate between the bank and the target company (such as private equity funds). Here the bank has no direct knowledge of the strategy or operating procedures, as opposed to cases of investment in vehicles for which operational goals and intervention are known. Therefore, the ruling seeks to discourage banks and banking groups from “stock-picking” a variety of private equity funds. With the passing of time, the impacts of this discipline on the future market evolution will need to be assessed.

### 3. EMPIRICAL ANALYSIS: TARGETS AND ADOPTED METHODOLOGY

The final empirical analysis relates to those intermediate banks that assume the identity of local banks because of the importance of local factors—such as the increased presence of companies which specialize in high technology have a significant capacity to innovate—in the genesis of technological districts.

Some other important features of technological districts, which explain why we have focused exclusively on this class of intermediary, include geographical proximity, relational proximity, and the consultancy role played by financial services in supporting their growth.

The analysis was carried out on local banks operating in the leading regions for private equity (AIFI Reports) and, furthermore, accommodating those technological districts that despite their young age (all the technological districts began operation from 2000 to 2003), differ from the others by their dynamism in terms of successful initiatives they have implemented.

Attention was focused on the regions of Piedmont, Veneto, Lombardy, and Emilia–Romagna, which have districts with respectively the following specializations: wireless technologies, nanotechnology, biotechnology, and advanced mechanics. The sample consisted of 71 local banks distributed as follows: 30 in Lombardy, 22 in Veneto, 12 in Emilia–Romagna, and 7 in Piedmont. This sample was selected using two criteria: the registered office of each local bank and the number of branches. In this way, we were able to identify the main territory where each local bank operates.

Within the sample of 355 observations, the Lombardy region shows the greatest number of cooperative banks and popular banks. Second in this regard comes the Veneto region with an increasing presence of local banks, and third the Emilia–Romagna region. The Piedmont region is characterized by the lowest number of cooperative banks and popular banks.

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Table 2 – Sample Structure (source: our processing)

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	<b>355</b>	<b>100.00</b>	

The financial sector examined here is the merchant banking sector, as it contains within it private equity transactions. In order to monitor the level of dissemination in this financial sector of local bank efficiency, we have made an estimation using a panel model, rather than, for example, a simple linear regression model. This is because we have monitored different observation units (i.e. 71 different local banks) in different times.

We then chose to estimate with a panel model using 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, to check if there are discrepancies between the regions investigated in offering these advanced financial services.

There may be differences between local banks in management of these advanced financial services caused, for example, by the quality of bank management, the presence or absence of a skills portfolio (Forestieri, 2007), and other factors.

Since we have no proxy for monitoring each of these skills, we decided to treat the quality of bank management and each of these skills as individual effects, constants, and unknowns ( $a_i$ ), of a generic panel model with fixed effects.

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 have been chosen in order to meet the aims of this empirical analysis.

#### 4. MODEL VARIABLES

In the panel model, the dependent variable, indicative of bank profitability, is constructed as the ratio between two aggregates of income: the interest margin and the earning margin. This ratio thus provides guidance in respect of 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 with collateral management.

At constant interest margin, higher values of this quotient denote a lower capacity of 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.

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Table 3 – Explanatory Variables Model Panel (source: our processing)

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

The first variable (TDRS) provides information on the contribution in revenues from the services provided in the bond-buying business. In particular, the dynamics of this variable may provide some indications as to the spread of financing operations, which represent a mode of expression of *merchant banking*. Typically, these operations are in fact performed by the merchant bank, in the technical form of the subscription of convertible or nonconvertible bonds.

The second variable (TCRS) provides information about the incidence of the average percentage of financial assets available for sale, relating to equity securities, as part of the economic aggregate revenues components from services. In other words, this variable can provide guidance

on the occurrence of another way of carrying out *merchant banking*, namely the acquisition of shares in the social capital of the financed companies.

The third variable (CFRS) provides information concerning the average percentage incidence of commission generated from cash loans on net revenues by services, and in particular concerning the local banks' use of financial *covenants*, i.e. clauses that guarantee the right to redeem shares in the event of failure to achieve the set economic-financial parameters.

The last variable (DFRS) provides a measurement of the average percent 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 (Regio), which were crossed with each of the explanatory variables (and which identify whether local banks operate primarily in one of the four regions)

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

$$Profitability = \beta_{1i} + \sum_{i=1}^4 \beta_i \cdot Regio + \varepsilon_{it}$$

In a more extended form:

$$\begin{aligned} Profitability = & \beta_{1i} \\ & + \beta_1 \sum_{i=1}^{77} \sum_{t=2006}^{2010} TDRS_{it} \cdot Regio \\ & + \beta_2 \sum_{i=1}^{77} \sum_{t=2006}^{2010} TCRS_{it} \cdot Regio \\ & + \beta_3 \sum_{i=1}^{77} \sum_{t=2006}^{2010} CFRS_{it} \cdot Regio + \beta_4 \sum_{i=1}^{77} \sum_{t=2006}^{2010} DRS_{it} \cdot Regio + e_{it} \end{aligned}$$

## 5. RESULTS

With reference to the first variable (TDRS), inhomogeneities emerge within the sample: in fact, with the exception of the Emilia–Romagna and Lombardy banks, no bank relied on the sales of debt securities to raise their levels of economic performance. At a confidence level  $\alpha$  of 5%, the coefficients estimated for this first explanatory variable are significantly different from zero only for local banks operating in those two regions.

Therefore, the financial assets available for sale in the form of financing transactions in the merchant banking sector have exerted a significant contribution on the economic performance of the 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 greater attention to the profitability of services management (i.e. to the components of gross income) rather than to the profitability of money management (i.e. the components of net interest income).

In particular, the cooperative and popular banks in Lombardy and Piedmont are united by an average equity/services income quotient over the three-year period of the study, which is particularly significant in their financial statements.

The p-values associated with the estimated beta coefficients are lower than the confidence level  $\alpha$  (5%), thus prompting the rejection of the null hypothesis of significance absence of the estimates.

For all the banks located in other regions, equity securities and then acquisition of equity interest in the target company did not form an important determinant within the aggregate economy of net revenues from services—which indicates that greater attention was paid by these banks to the profitability of money management (i.e. to the components of income from net interest) rather than to their management services.

Regarding the third set of variables (CFRS), which provides information on the average percent incidence of commission generated by the credit commitments of net revenues from services, we noted the following behaviours among the banks in the sample: in all the regions considered, the local banks have in common variable values not close to zero, which thus indicate the presence of a significant contribution to the dynamics of the economic aggregates.

This is indicative of the 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%, leading to the confirmation of the relevance of these variables to the earning capacity of local banks in all four regions surveyed. In order to give an economic explanation of these results, it is possible to say that local banks in the analysed sample prefer to receive these guarantees than to resort to other mechanisms for protecting their investments, such as playing an active part in the process of management appointment, possessing the right to appoint one or more members of the board of directors of the subsidiary, or even concluding no eligible contractual clauses 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 for the period 1993–1998.

That author argued that the increase in bad debts during that time indicated that local Sicilian banks had accepted a high level of credit risk, which was why they demanded greater guarantees from clients. It was also suggested that had committed errors in the evaluation of credit risk, with the result that, since they did not demand adequate guarantees, they faced large losses. Compared to larger banks operating in extra regional territories, according to Baravelli, local banks did not implement high pricing policies and did not expand their loan portfolio to meet external competition, instead preferring to maintain and strengthen existing relationships with their customers.

They thus managed to preserve their market share and reduce the damage that might be generated from indiscriminate development activity—increasingly marked by the centrality of pricing policies and a lack of care in the evaluation of creditworthiness.

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 contracts. In the past, covenants had often been requested by the borrower and accepted by the lender in order to close the transaction and then to sell the debt more or less rapidly.

Today, however, it is the *lenders* who 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 a substantial part of the debt on their financial statement for longer time.

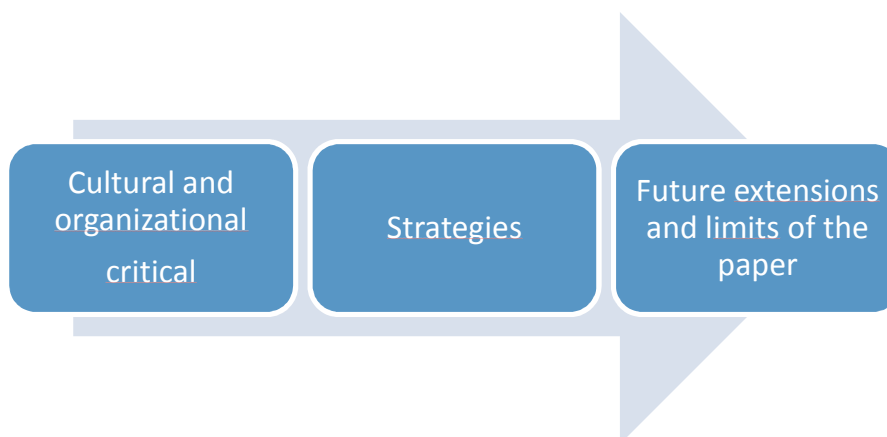
With reference to the last variable (DRS), with the exception of Lombardy banks, we found that the contribution of available financial assets and investments in the form of coupons and dividends has taken on a quite residual significance among the components of the aggregate net income from services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

With a p-value of 5%, the estimated coefficients for this explanatory variable in the other three regions are not significantly different from zero, which suggests a barely significant influence on the profitability of local banks operating in these regions.

## 6. CONCLUSIONS

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

Figure 1 – The central issues. (source: our processing)



The empirical analysis showed that local banks operating in the regions of technological districts are still far from becoming multi-product, multi-market, multi-technology, and multi-sector firms. In other words, local banks cannot be configured as multi-specialist intermediary banks, that is, banks that would be able to coordinate many activities by adopting division and specialization within their activities. Nor can they easily be configured as multi-business banks, which would be able to ensure a greater correlation between the various strategic business areas (ASA).

In recent years, a new economic situation arose, necessitating a review of the system of relations between banks and companies, including the question of when intermediary banks assume the role of local banks. The two main events were the introduction of new financial rules known as Basel 2, and the spread of the global financial crisis.

In light of these two financial and economic events affecting the banking operations and the nature of the Italian business system, the new role that the banking system is to play in promoting the growth of companies will involve many challenges. The combination of these challenges will lead to each bank, whether local or national, defining its own competitive positioning on the market and accepting new organizational models.

A first challenge is size: size is necessary for efficiency, but in future, it will be necessary to ensure the expansion of services in a way consistent with the characteristics of demand, while continuing to protect and enhance the distinctive characteristics of local banks. The second challenge is the network: smaller banks will need to choose a mode (aggregation, delivery) so that their small size does not represent an obstacle to the diversification of the supply portfolio, and so to their ability to support companies.

The third challenge, that of professional relationships, 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 to listen to and interact with customers).

Banks will need to acquire information from the world of business, and use that information—disseminated mainly at central and peripheral levels—in knowledge and skills that are useful for company services. This means moving the concept of information from a *people-specific* valence (where information is the people’s asset and not the bank’s asset) to a *firm-specific* valence (which makes information on customers advantageous to an organization).

The fourth challenge, that of internationalization, emphasizes the role of banks as necessary infrastructure for development abroad, so distinctive techniques for the internationalization of companies, especially for small ones, become a clear factor in the creation of competitive advantages.

The fifth challenge for assessment involves the ability to mediate and synthesize very different instances that converge on the evaluation of counterparties. Banks will need to reach an effective combination of rigour and the needs of objective measures required by risk management systems and the presence of medium-term relations and confidential information that emerge in the relation with companies. This does not necessarily entail lowering the level of rigour and objectivity of judgment regarding the creditworthiness of the retail counterparty, but rather would involve integrating information which is difficult to systematize in an objective context.

The organizational aspects can be conceived as a strategic variable which banks must confront in order to successfully compete 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 or long-term falls more and more among the factors that lie 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 diffuse network of branches in a territory may not be sufficient to make successful the strategies of operative differentiation among these banks. The transition from a single organizational functional structure to a divisional one would represent the ideal solution to this problem. The adoption of a divisional organizational structure leads banks to rethink their policy of diversification and segmentation, as well as their 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 bank; in fact, the transformation of the identity of these banks into global financial partners for companies demands specific skills: not only relational skills, but especially technical, financial, fiscal, and industrial/sectoral, with planning and strategic control.

All explanatory variables in the panel model were significant only in the Lombardy region, while greater heterogeneity was apparent in the other three investigated regions. This remark indicates, in our view, that local banks operating in Lombardy can be considered eligible financial partners

of small and medium-sized enterprises located in this region, and are thus capable of diversifying their supply model working in the private market equity.

On the contrary, the banks operating in the other regions investigated were not entirely able to couple their intrinsic ability to improve customer loyalty with the financial, managerial, and industrial skills necessary for the implementation of *merchant banking*.

Most likely, these banks still adopt the logic of granting credit based on insurance, with the consequence of high diversification risk (obtained through a consistent fractionation) rather than operations focused on relationship value. A greater preference for long-term relationships with customers will lead local banks to assess credit risks not by choosing a static analysis, but by evaluating the quality of entrepreneurial projects.

Another mentality that local banks will need to acquire in order to diversify their supply system toward the *corporate* and *investment banking* services is the ability of evaluate of the profitability of relationships with customer over time (a relationship-oriented approach) and not simply over an individual transaction (a *transaction-oriented* approach). The adoption of this new approach should induce banks to support the customer even in situations of financial difficulty, if they are convinced of a recovery in the medium or long term. Another shortcoming of local banks is the lack in their organizational structure of an important professional role for the *corporate banker* (*account manager* or *client manager*). It is likely that these banks have tried to replace this profile with other organizational figures such as a credit analyst or branch manager (Baravelli, 2002). Unlike these two professional roles, a *corporate banker* has a financial, commercial, and relational-structured cognitive mindset that allows him to fulfil the function of a connecting link between the credit and commercial divisions. The complexity of this mindset can be traced to the fact that this organizational role is responsible for a variety of tasks, such as the evaluation of a company's potential, as well as the acquisition of the relationship, assessments of creditworthiness, definition of financial and credit assistance, price management, and relationship monitoring. The *corporate banker* should be able to exploit the information gained in analysing the financial risks of the company for commercial purposes, and should also use the information collected for commercial purposes in the assessment of creditworthiness, so as to detect in advance any impact on the company. At the same time, he or she would be able to improve all the possible informative synergies with other distribution channels or product units belonging to the bank.

Another possible explanation of the low uptake of advanced *corporate banking* financial services within the supply system of local banks sampled may be related to the finding that, in these banks, the organizational figure of *corporate banker* has tended to act as a global consultant for SMEs with limited financial needs, rather than as a "facilitating" *corporate banker* able to promote the value of relationships with customers within the bank; such a 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 private equity services, local banks may use the following strategies:

1. funding buy-back mechanisms;
2. promoting co-investment logic;
3. developing a "widespread" value chain;
4. providing support for enhancing mechanisms.

The first strategy aims at the relevance role that the companies' capitalization plays in the bank-company relationship (and therefore in ratings and in access to and cost of credit), as well as in the development of corporate finance transactions.

In particular, the use of a private equity fund operated by an enterprise, in addition to requiring organizational and cultural critical issues to be overcome, necessarily requires the possession of specific dimensional requirements. In fact, these funds do not invest below a certain threshold of company sales; a level that is conventionally identified as 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 distributed according to the logic of direct disbursement by the banks of the territory of the indirect scheme through trust.

The spread of co-investment logic refers to the use of private equity as an instrument for attracting and proliferating resources for SMEs. The development of private equity in favour of smaller companies cannot be based only on support mechanisms related to the buy-back and linked to the demand support, but also on support mechanisms based on the supply of funds. In this sense, one of the obstacles to investing in smaller companies is still the excessive risk related to the expected return. In this regard, one possible strategy to encourage private investors to allocate the private equity to SMEs is to create joint public-private funds where losses are shared, but in the case of profit, the public investor's remuneration is predetermined and, consequently, the private investor's is variable. This mechanism, known as *up-slide leverage scheme*, allows private entities to co-invest (therefore employing less capital), and so to bear losses but to benefit asymmetrically (and profitably) from revenue, balancing the risk-return relationship. The promotion of local funds characterized by this up-slide leverage mechanism would allow significant intervention in support of smaller companies, which are also affected by the crisis situation.

With reference to the strategy of creating a common value chain, the presence of local banks in a territory can be used in a decisive manner for the approach of private equity firms to smaller firms. This occurs by two different mechanisms. On one hand, the knowledge of the territory can contribute significantly to enhancing *origination* activities, thereby ensuring continuous cash flows to SMEs.

On the other hand, the entire value chain of the private equity process (origination, screening, evaluation, and due diligence) may be largely decentralized throughout the territory, according to a logic of co-responsibility among private equity funds and local banks to lowering their costs and creating awareness of small companies.

A strategy to support enhancing mechanisms, i.e. to guarantee and mitigate credit risk, can be achieved through trust, where mutual spirit and knowledge of the territory can play an important role in overcoming the critical size problem. However, trust (however precious and essential it is) must evolve from support for ordinary loans and for equity transactions whose main increased risk can be counterweighed by the presence of incentives and *ad hoc* funding from the same system of banks.

Ideas for future development of this research include:

1. Enlarging the sample of banks considered, in order to undertake a comparative analysis of the degree of diversification present in the supply model of banks in the north, centre, and

south of Italy, and also to consider other categories of intermediary bank operating in the investigated regions

2. Incorporating explanatory variables into the model as characteristics of regional firms—such as age, size (including turnover and number of employees), sector specialization (Lazzeroni M., 2004), ROI and degree of financial autonomy (Source: AIDA Database)
3. Incorporating into model panel explanatory variables or proxies for the intensity of bank-firm relationships (Bisoni C., 2010; Munari L., 2011)

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**APPENDIX**

Table 4. List of investigated local banks.

<b>Regions</b>	<b>Local Banks(registered office, number of branches)</b>
<b><i>Piedmont</i></b>	BCC Vagienna(Bene Vagienna, 18)-BCC Caraglio(Caraglio, 17)-BCC Casalgrasso (Sant'Albano Stura, 17)-BCC Cherasco(Cherasco, 24)-BCC Pianfei(Pianfei, 9)-BCC del Canavese (Torino, 10)-BCC Alba(Alba, 45)
<b><i>Lombardy</i></b>	BCC Bergamasca(Zanica, 17)-BCC Valle Seriana(Pradalunga, 8)-BCC Basso Sebino(Capriolo, 8)- BCC Brescia(Brescia, 56)-BCC Calcio e Covo(Covo,18)-BCC Caravaggio(Caravaggio, 19)-BCC Inzago(Milano 12)-BCC Pompiano(Pompiano,42)-BCC Orobica(Cologno Al Serio, 11)-BCC Garda(Montichiari, 28)-BCC Cremonese(Casalmorano, 18)-BCC Bedizzole(Bedizzole, 18)- BCC Agrobresciano(Ghedi, 25)-BCC Castel Gofredo(Castel Gofredo, 10)-BCC Carate Brianza(Carate Brianza, 26)-BCC Cantù(Cantù, 29)-BCC Padana(Leno, 37)- BCC Cremasca(Crema, 19)-BCC Alta Brianza(Alzate Brianza, 14)-BCC Binasco(Binasco, 14)-BCC Buguggiate(Buguggiate, 18)-BCC Sesto San Giovanni(Sesto, 15)-BCC Triuggio(Triuggio, 15)-BCC Valsabbia Raganella(Vestone, 7)-BCC Adda(Rivola D'Adda, 10)-BCC Barlassina(Barlassina, 14)-BCC Sorrisole(Sorrisole, 12)-Banca Popolare di Milano(Milano, 384)-Banca Popolare di Sondrio(Sondrio, 218)- Banca Popolare di Valsabina(Vestone, 55)
<b><i>Veneto</i></b>	BCC Adige Po(Lusia, 12)- BCC Alta Padovana(Padova, 35)-BCC Alto Vicentino(Pojana Maggiore, 10)-BCC Benaco(Costernano, 7)-BCC Brendola(Brendola, 21)- BCC CentroMarca(Preganziol, 12)-BCC Cortina d'Ampezzo(Cortina, 9)-BCC Veneziano(Mira, 23)-BCC Marca(Orsago, 12)-BCC Monaster del Sile(Monastier di Treviso,. 26)- BCC Marcon(Orsago, 12)-BCC Prealpi(Tarzo, 23)-BCC Roana(Roana, 13)-BCC Romano e S. Caterina(Grappa, 13)-BCC Sant'Elena(Sant'Elena, 18)-BCC Valpolicella(Marano di Valpolicella, 9)-BCC Verona(Verona, 14)-BCC Trevigiano(Vedelago, 29)-BCC San Giorgio(Fara Vicentino, 20)-Banca Popolare di Marostica(Marostica, 46)-Banca Popolare Etica(Padova, 3)-Banca popolare di Vicenza(Vicenza, 261)
<b><i>Emilia Romagna</i></b>	BCC Reggiana(Guastalla, 19)-BCC Ravennate e Imolese(Faenza, 44)-BCC Bologna(Bologna, 32)-BCC Cavola e Sassuolo(Toano, 14)-BCC Cesena(Cesena, 20)- BCC Forlì(Forlì, 19)- BCC Gradara(Gradara, 8)-BCC Valmarecchia(Rimini, 13)- BCC Romagna Est(Belluria, 22)-Banca Popolare dell'Emilia Romagna(Modena, 241)-Banca Popolare di Valconca(Morciano di Romagna, 27)- Banca Popolare San Felice(San Felice sul Panaro, 19)

Table 5. Output of the private equity in thechnological districts and profitability

Observations = 355 – Sampled Banks = 71 -  $R^2$  : within estimator= 0.3931 -  $R^2$  : between estimator = 0.0011 -  $R^2$  : OLS estimator = 0.0674 -  $F(16,268) = 10.85$  Prob > F = 0.0000

PROFITABILITY: DEPENDENT VARIABLE			
Explicative Variables	Estimates ( $\beta$ )	Standard Error	t-ratio
TDRS <sub>Romagna</sub>	-.0024776**	.0011461	-2.16
TDRS <sub>Lombardia</sub>	-.0021535**	.0005541	-3.89
TDRS <sub>Piemonte</sub>	.0020658	.0012354	1.67
TDRS <sub>Veneto</sub>	.0000291	.0006221	0.05
TCRS <sub>Romagna</sub>	-.0031443	.017865	-0.18
TCRS <sub>Lombardia</sub>	.0327432**	.0158114	2.07
TCRS <sub>Piemonte</sub>	.018349**	.0045764	4.01
TCRS <sub>Veneto</sub>	.0428178	.0219142	1.95
CFRS <sub>Romagna</sub>	.0075852**	.0020401	3.72
CFRS <sub>Lombardia</sub>	-.0012612**	.0006273	-2.01
CFRS <sub>Piemonte</sub>	.0286654**	.0083221	3.44
CFRS <sub>Veneto</sub>	-.0057621**	.0024579	-2.34
DRS <sub>Romagna</sub>	-.4008466	.5214546	-0.77
DRS <sub>Lombardia</sub>	1.844903**	.3346828	5.51
DRS <sub>Piemonte</sub>	-.0011445	.0023021	-0.50
DRS <sub>Veneto</sub>	.5601624	.9866148	0.57
Costante	.7300348	.0078625	92.85

$F(70,268) = 5.52$  Prob > F = 0.0000

\*\* the estimates are significant with at a confidence level  $\alpha$  of 5%

<sup>i</sup> To conform with Italian regulations on academic publishing, we attributet hecontribution of each author as follows, even though the article is the joint work of both authors: Massimo Arnone, sections: 1, 3, 4 and 5 - Alessandra Bechi, section: 2.