

---

# FROM DEBT TO EQUITY: THE ITALIAN SHIFTING POLICY

Unquote Italia

Milan, November 11, 2010

*Andrea Montanino*

*Ministero dell'economia e delle finanze, Dipartimento del Tesoro*

---

**• Macroeconomics on debt: why it is time to focus on changing from a debt economy to an equity economy**

• The new “Fondo Italiano di Investimento”: a public-private partnership for reinforcing Italian firms

## The debt is an essential tool for the economic development...

---

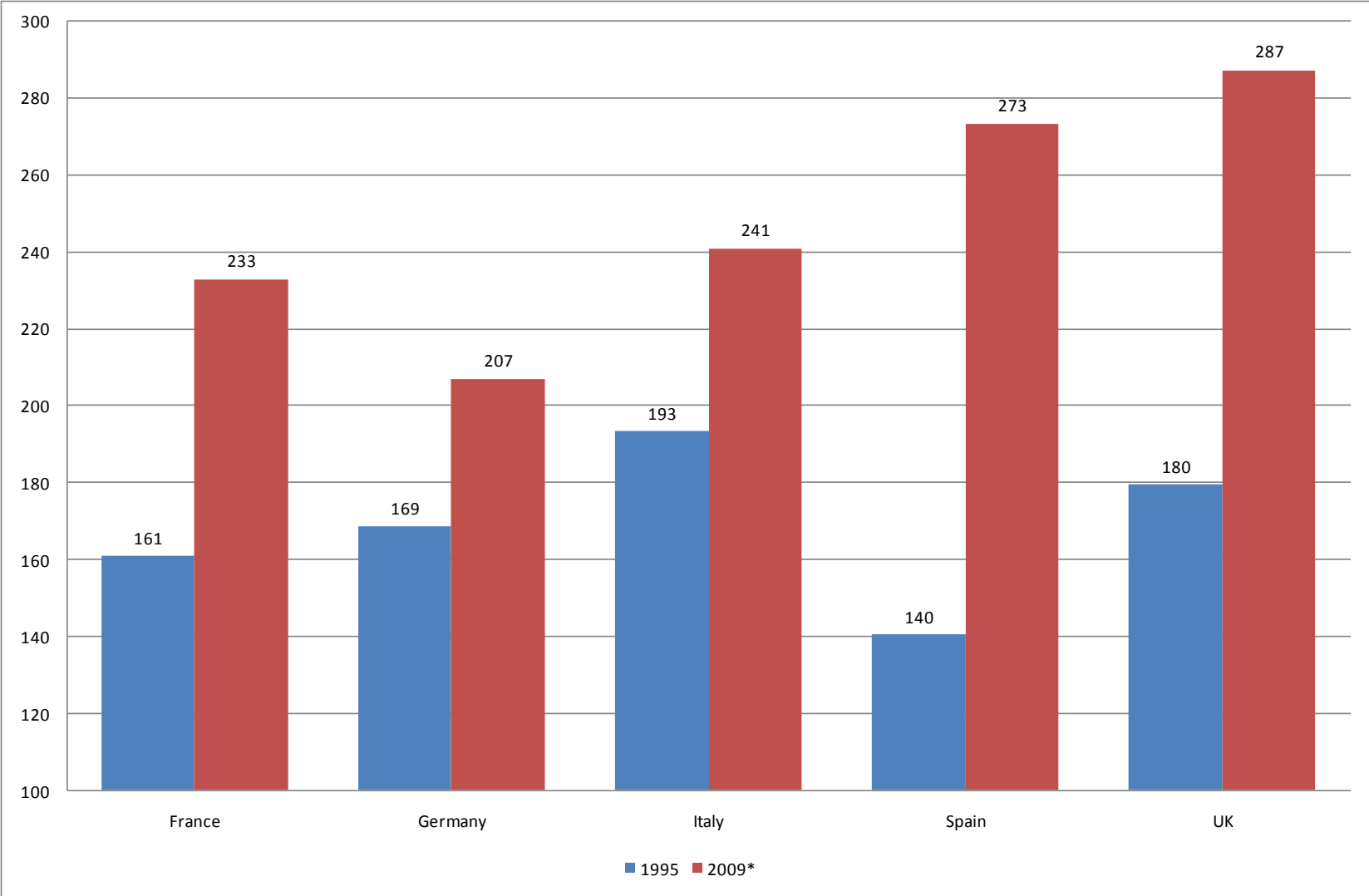
- Capitalism required the **establishment of banks and financial intermediaries** to provide credit for the development
- The debt is **an essential tool for the economic development** and allows a better allocation of the resources overtime – think about the Adam Smith's brewer
- Debt is not bad *per se*. What matters is:
  - The **use** of debt
  - The **dimension** of debt
  - The **quality** of debt

## ...however it recently expanded oversize

---

- The **debt expansion** which occurred in the main world economies since the Nineties is “**abnormal**”. Until then:
  - public debt used to increase during slowdown and to reduce in upswing
  - private debt has historically compensated public debt (e.g. dropping during war periods and increasing in peace)
- In the last 5-7 years, families’ and companies’ **behaviors diverged** from the historical trend with a **sensible increase of their indebtedness** and also public debt on GDP returned to grow
- At the end of 2009, the **total level of debt** (public and private) in the main world economies is much **bigger** than that existing in mid nineties.

# Total (public and private) debt expansion (as % of GDP)



## The crisis showed that a debt economy is unsustainable

---

- The risk that from a certain level the **debt** could have become **unsustainable** has been undervalued

The pathologic debt expansion in several areas in the World is **the first failure of the growing model based on imbalances** which have been enlarged over time

- It is therefore clear that an important component of the **economic growth** of some capitalistic countries was determined by **debt**
- A **physiological** element of capitalistic economies **became pathologic**

# A new model must be implemented for the future to foster economic growth

---

## 1 Governments' debt

- **Limited space** to sustain private firms through public incentives – Stability and Growth Pact

## 2 SMEs' debt

- **Private firms already indebted** given the level of revenues and capitalization: this is one of the effect of the current crisis
- For the future, it will be **difficult** to get **additional credit**

## 3 Basel III

- New capital requirements for banks (**Basel III**) **might limit the supply of financial resources** towards private firms, especially SMEs

## Need to think a new political economy for Italy

---

### A win-win approach:

- Set up policies based on the **convergence of public and private interests**, where financial resources are mostly private: the “**State-promoter**” takes the place of the “**State-distributor**”
  - State/local Public Body as facilitator/promoter of a process, as sponsor, as regulator (makes laws/regulations to encourage private sector’s interventions)
  - Private sector (banks and financial institutions) as investors/financer of the initiatives

Main lesson for Italy - move to the opposite: from *public* to *private*, from *debt* to *equity*

**From public debt to private equity**

# Need to shift forward capital injections to sustain economic growth

---

In Italy, **economic growth** tightly depends from **SMEs** (mostly manufacturing and export-led) which represent the **productive backbone** of the Italian economy

The low level of capitalization of Italian SMEs and the little “space” to increase the level of debt require an important **capital injection program** to make these SMEs **more solid** and **capable to compete in the international markets**

**Private equity** might be the **right tool** to address the solution, given the following constraints:

- Structural shifting **from LBOs to expansion** projects
- Interventions subject to an accurate and in-depth analysis of the **solidity of growing projects** of the companies

- Macroeconomics on debt: why it is time to focus on changing from a debt economy to an equity economy








- **The new “Fondo Italiano di Investimento”**: a public-private partnership for reinforcing Italian firms

The Italian State, Cassa Depositi e Prestiti, the banks, the Italian banking association (ABI) and the Italian employers' association (Confindustria) share the common purpose to create, in the mid-run, a wider range of “**middle national champions**”, through:

- **Increase of small and mid companies' equity:**
  - easier access to credit
  - support to development projects for the mid-long term
- **Incentive to the aggregation process of SMEs**

# Sponsors of the project

7 shareholders on equal terms, with equal stakes in the management company, same administrative and financial rights

Shareholders	Paid-in capital	Ownership stake
 <i>Ministero dell'Economia e delle Finanze</i>	0.5 mln €	~14.3%
	0.5 mln €	~14.3%
	0.5 mln €	~14.3%
	0.5 mln €	~14.3%
	0.5 mln €	~14.3%
	0.5 mln €	~14.3%
	0.5 mln €	~14.3%
<b>6 additional banks joined in august 2010</b>	<b>Share-capital of the management company</b> 3.5 mln €	<b>100%</b>

## A unique model of public-private partnership...

Fondo Italiano d'Investimento is a project with a strong institutional characterization, where the stakeholders share the common purpose, carrying in the same time different financial interests

Italian Ministry of Economy and Finance

- Represents the Italian State and it is aimed at **promoting the project** (which represents a new way of thinking up the public finance) ensuring the convergence of public and private interests

Cassa Depositi e Prestiti (CDP)

- This is a kind of an investment bank of **hybrid nature**, being 70% owned by the State, but out of the perimeter of the Public Administration
- CDP's commitment represents the **strong willingness of the State** to sponsor and sustain the initiative

Italian industrials' association (Confindustria)

- Represents Italian companies, which are the first "beneficiaries" of Fondo Italiano d'Investimento and it is aimed at **assisting entrepreneurs** to correctly understand and approach this initiative

Banks

- The three biggest Italian banking groups, 6 middle size banks (Popolari) aim to an **adequate return on investment** and to the creation of a bunch of (potential) clients which become **more solid and competitive** in the international markets

Italian banking association (ABI)

- Represents the entire Italian banking community and it is aimed at **sharing the project with other banks** on top of the three sponsor banks

# ...with a distinctive value proposition

Detailed in the next page

## Key points

## Description

### Risk profile

- **Risk taken** by the Fund generally **lower** than other Funds' average:
  - **Financial** risk: limited (e.g., no leveraged buyout and limited recourse to management buyout or family buyout)
  - **Industrial** risk: even higher than other Funds' average:
    - ✓ longer holding period (where required by the business plan implementation)
    - ✓ investment extended also to mature / lower growth industries
    - ✓ higher flexibility in exit structuring

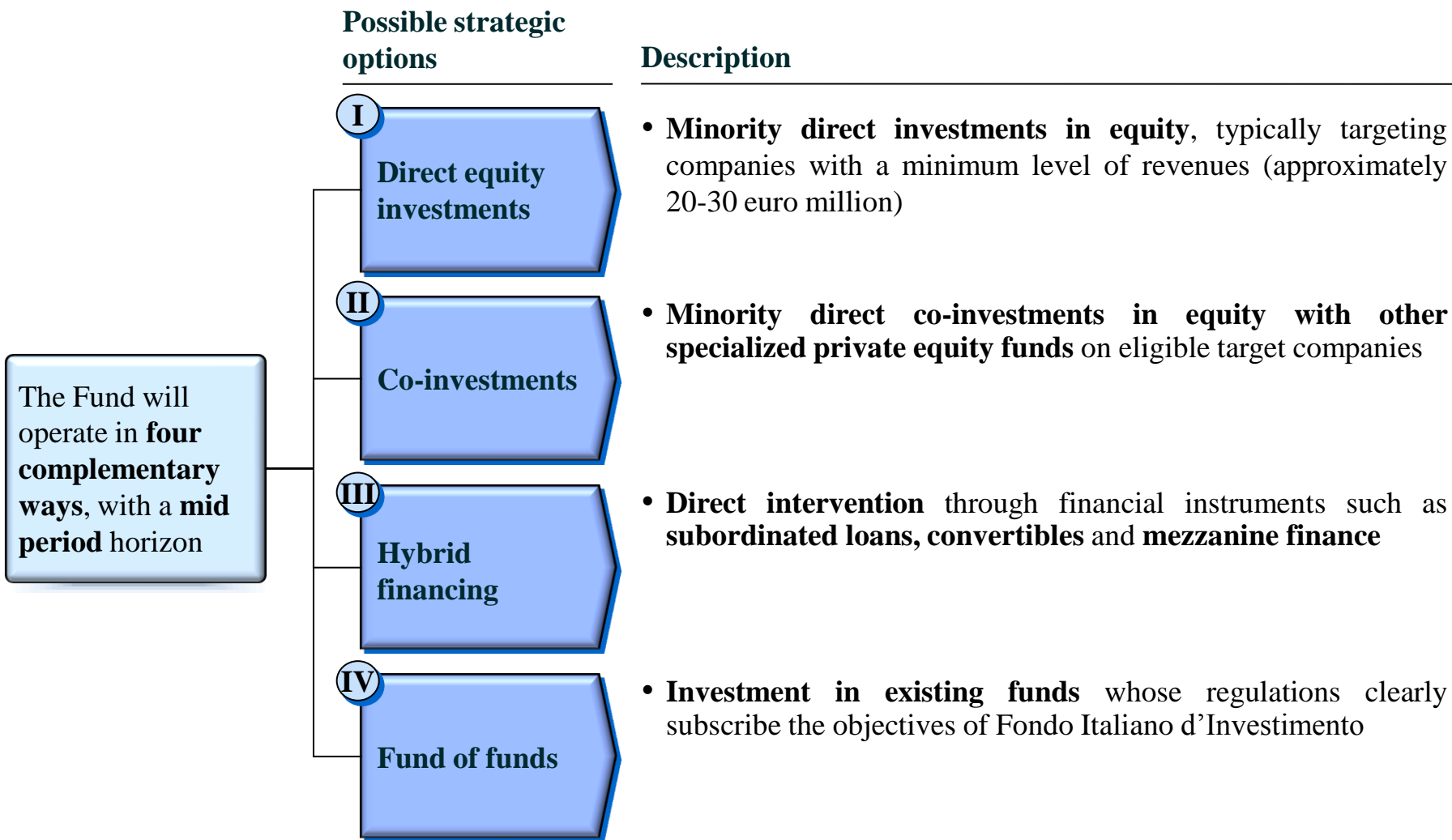
### Return profile

- **Expected return** related only to strategic and industrial perspectives
- In case of **indirect intervention with other investors** (Fund of funds) possible return differentiation (e.g. cap) to be evaluated

### Investment modalities

- **Flexible** ways to invest through the following tools:
  - Direct equity investments
  - Co-investments
  - Hybrid financing
  - Fund of funds
- **Institutional purpose of significant intervention with direct investments to support corporate development, also encouraging a process of aggregation**
- The need to **quickly start up investments** and to make the **structure** of the Fund **economically sustainable** (through a non excessive dimensioning) might lead to more efficient asset allocation schemes (e.g., indirect investment as Fund of funds)

# Possible investment modalities



## Concluding remarks

---

- The Stability and Growth Pact requires many years of high primary balances.
- There is limited space (and scope) for an economy pushed by public debt.
- Moreover, Italian firms (especially SMEs) are already highly indebted, and there is limited space for increasing their debt.
- Public-private partnership for capital injection might be a way to improve the Italian rate of economic growth through a mix of public interests and private tools.

**Thank you!**