

# Developing venture capital activity to promote entrepreneurial competitiveness: Italy's case history

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## Abstract

*Il presente contributo intende analizzare la rilevanza a livello sociale ed economico della creazione di un "ambiente" favorevole allo sviluppo del venture capital in Italia. Gli autori dimostrano la rilevanza di questa tipologia di attività per la nascita e lo sviluppo di nuove imprese e, attraverso un modello econometrico sperimentale, presentano le determinanti e, dunque, le principali leve attivabili attraverso cui è possibile favorire lo sviluppo del mercato del venture capital. Il sostegno alle imprese oggetto di investimento si traduce, a livello di sistema economico, nella opportunità di sviluppo e di consolidamento per nuovi "campioni" nazionali, che, viceversa, avrebbero maggiori difficoltà nell'emergere come realtà di eccellenza.*

*Parole chiave: venture capital, impresa, sviluppo economico, competitività*

*This paper analyzes the importance of creating ideal conditions in order to develop venture capital in Italy. The authors demonstrate the importance this activity plays in the development of new ventures and, through an experimental model, they present the most important determinants or drivers leading to an expansion of the venture capital market. Support provided in the form of investments in target companies can - from a macroeconomic point of view - be interpreted as an opportunity for up and coming market players to develop into market champions and to consolidate that position for themselves in a way that would never have otherwise been possible.*

*Key words: venture capital, enterprise, economic development, competitiveness*

The purposes of this paper are to analyze the importance of creating ideal conditions for the development of venture capital activity in Italy and to identify the most important drivers capable of achieving this aim.

The authors start with some definitions of venture capital, after which they ("proceed by demonstrating") the importance of this kind of activity in the creation and development of new ventures. Finally, through an experimental model and

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personal reflections, they present the most important drivers leading to an expansion of the venture capital market in Italy.

### **1. Venture capital activity: definitions and benefits for new entrepreneurs**

European and American literature defines venture capital as investments aimed at stimulating new entrepreneurial activities (financing for start-up, *early-stage financing*) as well as further developing already existing businesses (financing for development, *expansion financing*) within the wider context of private equity investments. They represent the multitude of investments carried out by institutional investors in risk capital, who are internationally referred to as private equity and venture capital operators [Pratt, 1980; Gompers & Lerner, 2004; Gervasoni & Sattin, 2004; Ferrara, 2006; Zambelli, 2008; Lerner, 2009].

With reference to early-stage financing and the process of enterprise creation, the various steps a new venture must progress through have been identified as the following: seizing an opportunity, formalizing the idea, safeguarding from possible imitations, constructing a team, raising financial resources, bringing about the start-up, launching the new product. Without entering into deep analysis of the details in each phase, it is possible to affirm that, be it to a different extent for each phase, venture capitalists have to play an important role in all the above mentioned activities [Cardis, 2001; Brooke, 2009]. During early-stage deals, a future entrepreneur often needs more help than just a financial contribution and aid in developing a clearer definition of his business idea and entrepreneurial scheme; he or she also needs to be advised about his or her relative competitiveness on the market. Thus, one can say there are various benefits a future entrepreneur can draw from a relationship with a venture capitalist.

With regard to expansion financing, the operations in question have to deal with the various problems faced by an enterprise's development within different sets of conditions [Cary, 1995; Corigliano, 2001; Kraussl, 2007; Maci, 2009]. In this kind of participation, the nature of the risk capital investor's contribution is essentially one of providing financial support; however, it still retains a consultancy and advisory role, and the international network the investor can activate in order to facilitate external development is a particularly effective driver.

This category of investments is particularly suitable to the requirements of small and medium sized enterprises, which, indeed, have reached the point whereat they are ready to accomplish the final leap in their expansion process. This is a very common feature in Italy's entrepreneurial outlook, which is characterized by a high number of small to medium sized companies. These companies are often too small to survive on the international market.

Moreover, the presence of an institutional risk capital investor in such companies contributes to attracting skilled and qualified management as well as additional financial assets given the greater ease of opening new loans [Carlotti, 2006].

A fundamental way in which the presence of a venture capitalist contributes to the success of an enterprise's development plan lies in its ability to impose a new governance on the company. In fact, one of the conditions for the operation is that the entrepreneur accept new corporate governance patterns, including full book-keeping, managerial transparency, and the consequent mechanisms of control and reporting that are typical of public companies. With regard to enterprise governance, since both entrepreneur and investor share the same aims, acknowledgment of the importance of corporate structures and safeguarding minority shareholders represent the most important drivers determining the main rules regulating the rights of each stakeholder. In particular, a venture capitalist will expect representation in corporate boards and the power of veto over strategic decisions [Gervasoni, 2007; Berkery, 2008]. Moreover, the centrality of the Board of Directors must be sanctioned. These measures are often accompanied by providing stock option plans for managers who are fully involved in corporate decisions. This situation tends to align the interests of managers with those of shareholders, both of whose ultimate aim is the success of the company. The company will also be required to provide the investor with documentation keeping the investor regularly informed of the most important information concerning the company; this, so as to give the investor a better understanding of corporate structure, activities, policies and strategies, as well as economic and financial performance [Brooke, 2009]. Information on risk factors influencing business performance and on financial data is of great interest to the investor, and must therefore be provided regularly and reliably, for it stimulates higher quality business administration and control systems.

With particular reference to the governance of the company, it is also important to remember that the presence of a private equity player inside the company creates a range of conditions favouring the success of a future IPO (Initial Public Offering) [Lake, 2000; Benjamin & Margulis, 2005; Lerner, 2009].

## **2. Value creation: what do entrepreneurs and early-stage investors think about it?**

With regard to this, it is up to the venture capitalist's managerial skills to develop entrepreneurial worth by ensuring that the investment process encourages those companies to emerge and retain the greatest unexpressed potentiality. On the entrepreneurial side, the main drivers behind value creation have been studied and analyzed in depth for the last twenty years by a great many authors [Sahlman, 1999; Bygrave & Timmons, 1992; Romain, van Pottelsberghe, 2004; Benjamin & Margulis, 2005; Gompers & Lerner, 2011] as well as by various national associations [Aifi, 2003; Nvca, 2010]. In particular, the study by Aifi (Italian Private Equity and Venture Capital Association), which was based on a significant sample of entrepreneurs, has drawn attention to the fact that capital is generally perceived in a positive light. Moreover, the above studies have found the following useful drivers for business development in venture capital: the opportunity for

obtaining real attention from media & communication operators, the availability of financial services, support in the management selection process, advice on strategy and the availability of a range of professional and industrial contacts. The entrepreneur, therefore, expects various kinds of contribution from a venture capitalist [Hellmann & Puri, 2000].

As concerns the institutional investor, an interesting study [Brennan *et al.*, 2003] has identified the drivers that stimulate value inside a company: strategic support for the process of change, acting as a sponsor for the entrepreneurial group, improving the managerial skills of the administration, optimising capital structure, providing all the necessary professional competences and skills required in finance [Gompers *et al.*, 2009]. As is evident, there are a number of key-factors that are crucial to entrepreneurs and investors.

### **3. The fundamental role played by venture capital in terms of its economic impact**

Studies in Italian and international literature have highlighted how venture capitalism plays an important role in the financial markets by supplying new financial assets to unquoted enterprises with great potential for development. The impact such investors have on the market can be seen in statistics for employment, innovation and business efficiency, and measured in accordance with various ratios [Gompers, 1995; Hellmann & Puri, 2000; Romain & van Pottelsberghe, 2003; Kortum & Lerner, 2000; Jeng & Wells, 2000; Gompers & Lerner, 2004; Barocci, 2006; Timmons & Bygrave, 2009; Caselli & Sattin, 2011]. Thus, there is evidence of the positive effect that venture capitalism has on employment and economic performance.

Specifically, the empirical studies named below have attempted to ascertain the extent to which institutional investors contribute both to start-ups and to developing businesses. These studies have demonstrated that entry of a venture capitalist raises the economic and financial performance of a company above the average level of its market, thereby also benefiting quality of governance, research and development expenses, employment and investment growth.

In support of these claims, a study produced by the American National Venture Capital Association [Nvca, 2004] points out how target enterprises with a venture capitalist recorded an increase of 600.000 new employees between 2000 and 2003, with an annual average growth rate of 6.5%, in stark contrast with the trend of the private sector which recorded a decrease of 2.3% in the same period. Further, they were responsible for producing a turnover of approximately 1.800 billion, about 9.6% of the total turnover generated by all American enterprises.

The same goes for Europe, where the results of the latest study published on this topic by the European Private Equity and Venture Capital Association [Evca, 2005] underline the importance of the contribution made by venture capital to employment levels. In fact, it is estimated that between 2000 and 2004 companies involving the

participation of a venture capitalist had created 630.000 jobs, with an annual average increase of 30.5%; this value rises to 62% if spin-offs are included.

With regard to the situation in Italy, the authors studied a sample of 50 ventures, representing 30% of the entire market and including both early-stage and expansion businesses during the period from 1998 to 2004 [Gervasoni *et al.*, 2006]. Data processing has demonstrated that for every million Euros invested in the start-up of a new entrepreneurial activity, 13 new workplaces can be created after four years of business. The same amount of money assigned to development processes can generate 12 new workplaces during the period of cooperation with a venture capitalist. Relating such evidence to the total amount assigned to venture capital deals in Italy between 2000 and 2004, one can estimate approximately 46.000 new workplaces created thanks to companies being financed by venture capitalists, equivalent to 7.3% of the 630.000 new workplaces estimated by Evca for Europe during the same period.

Approximately 65% of companies benefiting from early-stage financing deals were recorded to have reached their break-even point, which is a significant percentage when one considers the very low proportion of entrepreneurial initiatives that actually survive the first stage in the “natural selection” process. It would not be realistic to reserve the same judgement for all the companies in the sample and some careful analysis will be useful to reach some meaningful conclusions. In fact, it has been highlighted first of all that venture capital investments have focused their attention on high technology sectors. Above all, successful ventures have been found to be those involving innovative enterprises (thanks to the adoption of new technologies, products or organizational structures) or ones operating in an as yet unexplored niche of the market. This situation turns them into sector leaders, at the very least, capable of conquering a significant share of the market or to highly distinguish their activity from that of any potential competitors.

In addition, another recent international research project, co-financed by the European Union and entitled “Vico” (Financing entrepreneurial ventures in Europe), has highlighted the significant positive impact of venture capital on the economic and financial performance of the enterprises involved and the contribution to employment growth [Croce *et al.*, 2010].

The positive economic impact of private equity and venture capital in Italy has also been confirmed in another recent research [Aifi, PriceWaterhouse Coopers, 2009]. The study focused both on venture capital and on buy-outs. From an aggregate point of view, the study showed how the impact of private equity and venture capital in Italy resulted in a 15% increase in the annual revenue of participated enterprises, as much as three times greater than the sample of medium-sized Italian enterprises normally taken as a benchmark. Furthermore, Italian medium-sized enterprises showed an annual increase of 4,5% in Ebitda figure for the 2003-2007 period, whereas companies supported by venture capitalists boasted an annual increase of approximately 28,2%.

Lastly, the participation of risk capital investors seems to have had a positive effect on employment, too, with companies stepping up recruitment by

approximately 8.1%. The medium-sized companies in the benchmark, on the other hand, showed no significant changes.

Thus, it has been demonstrated how venture capital does not only represent a new source of financial assets for businesses, but also a driver capable of producing multiple effects of great importance on investments, on the value chain and on employment, whether with reference to development process deals or ones supporting new entrepreneurial ideas.

#### **4. The most important drivers of venture capital in Italy**

All the above shows how very important it is for Italy to upgrade its use of this instrument, both when considering the presence of the instrument abroad and its proportion of the Italian Gross Domestic Product [Caselli & Sattin, 2011; Bracchi & Gervasoni, 2006]. In order to do so, it is important to identify the most important drivers underlying [Di Giorgio, 2002] this activity. For this purpose, it is particularly useful to refer to an experimental model [Gervasoni *et al.*, 2006] created by the authors, from which interesting results may be drawn concerning the key-factors influencing the dynamics of venture capital investments in Italy.

In order to identify the elements capable of influencing the growth of the market directly or indirectly, it is necessary to concentrate on identifying correlations between investment volumes and the trends of a number of variables that are as much a feature of the economic context as of the financial one. Unlike various international studies, it has been necessary in this one to leave out several variables that would certainly have been relevant to an analysis of venture capital activity, since the historical data available for them in the Italian context is either not available or unreliable. Wherever possible, a proxy solution has been adopted.

There follows a list of factors that the authors have identified as possible determinants of venture capital activity:

- IPO is the number of Initial Public Offerings on Italian regulated markets;
- GDP represents historical data for Italy's Gross Domestic Product;
- MTBOND represents historical data for the yield of mid-term bonds;
- LTBOND represents historical data for the yield of long-term bonds;
- STRATES represents historical data for short-term interest rates;
- LTRATES represents historical data for long-term interest rates;
- SPREADRATES is the difference between long-term and short-term interest rates;
- COMIT represents historical data for the Comit General index;
- COMITPE is the ratio between share price and earnings per share for the entire Comit General index;
- MKTCAP is the ratio between stock-market capitalisation and the Gross Domestic Product;
- PRIVINV reflects the sum total of fixed private investments, excluding investments in housing;

- LABCOST is an index for the cost of labour;
- LABPROD is an index for labour productivity in the private sector;
- DUMMY93 is a variable that accounts for the effects of law 344/93, which introduced closed-end funds.

So as to make sure the model is reliable, the authors only used data from official databases and nationally and internationally recognised sources, such as Datastream Thompson Financial, Movimprese, Consob, Borsa Italiana and Aifi. Both quantitative and qualitative collected data is directly produced by the above institutions or derived from primary references, such as the World Bank, the Organisation for Economic Co-operation and Development, the International Monetary Fund, Istat, the Bank of Italy or the Italian government. The period chosen for analysis lies between 1990 and 2003 (Tab. 1 e 2). The choice of the period was mainly dictated by the availability of data for certain historical series.

Taking venture capital investments into consideration, the authors didn't use a sample representing the whole market, but they considered all venture capital activities in Italy between 1990 and 2003 (the sum total of investments in seed capital, start-up and development capital). In this case, the source of data was the database of the European Venture Capital Association.

In this way, the model results particularly meaningful, considering that this kind of analysis is applied for the first time to the Italian context with such an extensive and detailed dataset.

From a methodological point of view, the authors mainly used two methodologies of analysis to construct this model: correlation and multivariate linear regression. Correlation has been used so as to sort from the previous variables whose course is consistent with the course of venture capital investments and with the number of new enterprises registered at the Italian Chambers of Commerce. They all turned out to be relevant to the analysis.

Multivariate linear regression, on the other hand, was used only later in order to understand how and to what degree these variables correlated with venture capital investments in Italy.

The formula is:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_k X_k + \varepsilon$$

where  $\alpha$  is the intercept,  $\beta$  the slope or angular coefficient and  $\varepsilon$  the erratic element. In this linear regression formula, the sum total of venture capital investments is represented by the dependent variable (Y), while all the others are explanatory variables (Xi). It is assumed that the explanatory variables (Xi) influence the dependent variable (Y) and that  $\beta$  is the coefficient measuring the degree of influence X has on Y.

Having defined both dependent variable and independent variables, an estimate is given for the  $\alpha$  intercept and  $\beta$  coefficients. This was done using the least squares method (Ordinary Least Squares - OLS).

As for tests designed to determine whether all  $\beta$  coefficients are equal to zero (t-stat and P-value), F test was computed.

It was immediately apparent from trial simulations that the number of IPOs in regulated markets and the GDP curve are the two variables bearing the highest statistical correlation.

Consequently, in order to avoid including too many regressors in the analysis, the variables representing the number of IPOs and the GDP values have been held constant, with regressors being inserted one at a time, so as to test the econometric formula. The regressors have been divided according to whether they are connected with stock market, financial or economic variables. As law 344/93, introducing closed-end funds, is considered by market operators as crucial for the development of venture capital in Italy, a control variable was inserted for 1993 in order to trace the effect of this legislation.

*Table 1: Estimates for financial factors influencing venture capital activity in Italy between 1990 and 2003*

Dependent Variable: Total Investments in Venture Capital						
Regressors	OLS <sub>1</sub>	OLS <sub>2</sub>	OLS <sub>3</sub>	OLS <sub>4</sub>	OLS <sub>5</sub>	OLS <sub>6</sub>
IPO	0.348 (0.0012)	0.361 (0.0003)	0.3677 (0.0004)	0.3522 (0.0009)	0.363 (0.0006)	0.361 (0.0243)
GDP	20.658 (0.0010)	35.082 (0.0007)	33.520 (0.0012)	31.017 (0.0036)	33.094 (0.0019)	19.092 (0.1708)(n.s.)
<b>Financial Variables</b>						
MTBOND		4.775 (0.0355)				
LTBOND			4.479 (0.0615)*			
STRATES				3.665 (n.s.)		
LTRATES					5.002 (0.0887)*	
SPREADRATES						-4.000 (n.s.)
<b>Control Variable</b>						
DUMMY93	yes	yes	yes	yes	yes	yes
R <sup>2</sup> adjusted	0.8287	0.8865	0.8736	0.8493	0.8644	0.8100
F-statistic	21.963	26.409	23.478	19.317	21.732	14.858
Prob(F-statistic)	0.000	0.000	0.000	0.000	0.000	0.000

N.B.: the data in the table are for estimated coefficients in the regression, the data in brackets indicate the level of significance. “\*” indicates that the estimate is significant at a 10% threshold, “\*\*\*” indicates that the estimate is significant at a 15% threshold; “n.s.” stands for not significant.

Source: self elaboration



*Table 2: Estimates for other factors influencing venture capital activity in Italy between 1990 and 2003*

Dependent Variable: Total Investments in Venture Capital						
Regressors	OLS <sub>7</sub>	OLS <sub>8</sub>	OLS <sub>9</sub>	OLS <sub>10</sub>	OLS <sub>11</sub>	OLS <sub>12</sub>
IPO	0.260 (0.0421)	0.321 (0.0500)	0.607 (0.0062)	0.340 (0.0031)	0.348 (0.0022)	0.3823 (0.0021)
GDP	13.438 (0.1206)**	20.793 (0.0019)	32.319 (0.0032)	24.544 (0.1065)**	20.581 (0.0102)	27.627 (0.0198)
<b>Stock-Market Variables</b>						
COMIT	1.067 (n.s.)					
COMITPE		0.429 (n.s.)				
MKTCAP (% GDP)			-1.194 (0.1294)**			
<b>Economic Variables</b>						
PRIVINV				-3.455 (n.s.)		
LABCOST					0.411 (n.s.)	
LABPROD						-17.593 (n.s.)
<b>Control Variable</b>						
DUMMY93	yes	yes	yes	yes	yes	yes
R <sup>2</sup> adjusted	0.8329	0.8107	0.8546	0.815	0.809	0.822
F-statistic	17.027	14.921	20.113	14.999	14.825	16.063
Prob(F-statistic)	0.000	0.000	0.000	0.000	0.000	0.000

N.B.: the data in the table are for estimated coefficients in the regression, the data in brackets indicate the level of significance. “\*” indicates that the estimate is significant at a 10% threshold, “\*\*\*” indicates that the estimate is significant at a 15% threshold; “n.s.” stands for not significant.

Source: self elaboration

A variety of econometric estimates were calculated and evaluated so as to obtain an output for the best regression. In searching for the best prediction formula, the authors used the R<sup>2</sup> index, which was adjusted as a benchmark parameter. From many simulations, the formula which produced the best estimates was the following:

$$VC = \alpha + \beta_1 IPO + \beta_2 PIL + \beta_3 BOND MT + \beta_4 DUMMY93$$

where:

- VC is the invested amount of venture capital investments in Italy;
- IPO is the number of Initial Public Offerings on regulated markets;
- GDP is the historical data for Italy's Gross Domestic Product;
- MTBOND is the yield from mid-term bonds;
- DUMMY93 is a dummy variable that attempts to account for the impact on the market of law 344/93, which introduced closed-end funds.

Substituting coefficients for the results of the analysis, the formula is the following one. The table 3 summarises the general output of the regression.

$$VC = -3929 + 0,36 * IPO + 35,08 * PIL + 4,77 * BONDMT - 174,23 * DUMMY93$$

Table 3: Output of the regression

Variable	Coefficient	Standard Error	Test - Statistic	P-value
$\alpha$	-3929.386	881.1860	-4.459201	0.0016
GDP	35.08257	6.899121	5.085078	0.0007
IPO	0.361426	0.063613	5.681597	0.0003
MTBOND	4.775411	1.932629	2.470941	0.0355
DUMMY93	-174.2309	70.10947	-2.485126	0.0347
R <sup>2</sup>	0.921491	Average for dependent variable		302.0214
R <sup>2</sup> adjusted	0.886598	Standard deviation for dependent variable		229.9560
Sum of residuals, squared	77.43812	F statistic		26.40916
Sum of regression residuals	53969.96	Prob(F statistic)		0.000055

Source: self elaboration

The formula shows the positive effect of dynamic stock markets (as measured by the annual number of IPOs, Initial Public Offerings), which tend to have a positive effect on venture capital activity. Such positive correlations can be explained on the demand side (enterprises) by a diffused climate of confidence towards financial markets, triggering a virtuous loop, tending to greater demand by enterprises for financing through release of capital to external subjects; whereas on the supply side (venture capitalist), the increase in the number of new quotations is linked to the exit process from participations, considering that approximately half the newly quoted industrial companies come from the portfolio of institutional investors [Bracchi, Gervasoni, 2006; Caselli & Sattin, 2011].

According to the formula, Italy's Gross Domestic Product is another main driver for the development of venture capital activity. On the demand side (enterprises), it would be reasonable to believe it easier both to start up new entrepreneurial activities and to develop existing businesses during periods of economic expansion. As for the supply of risk capital, less developed markets (such as the Italian one) are characterized by a majority of so-called "generic" investors, who do not specialize

in any single stage of the investment process and are consequently willing to invest in low risk projects during periods characterized by insufficient economic dynamism. Nonetheless, it is true that “contra-cyclical” investments, often made in enterprises with difficulties or looking for solutions to various problems preventing expansion (typically, buy-outs and turnarounds), require majority acquisitions and don’t appear in the venture capital activity analyzed here.

With regard to the supply of risk capital, periods of economic development are generally accompanied by an increase in the number of investors, thereby multiplying the volume of investments.

## **5. Is development and empowerment of venture capital activity an important aim?**

For many of the reasons above, venture capital within a national context appears to be more of an “accelerator” than an “engine” or driving force for economic development; in any case, it represents an important instrument supporting new entrepreneurship [Timmons & Bygrave, 2009].

So, how may one develop this activity and turn it into a driving force for economic development or, at least, a more effective and commonly used instrument than it is today?

In the authors' opinion, one cannot think of empowering venture capital without taking the complexity of the financial system into account. At first sight venture capital would seem to be “pro-cyclical”, acting as an “accelerator” of economic development, however, it could, with a certain amount of support, be upgraded for more complex enterprises and less favourable economic cycles (thereby acting as a driving force for development). This is especially the case with highly technological enterprises [Parente, 2004; Croce *et al.*, 2010; Caselli & Sattin, 2011], where it is particularly important to act on every step giving rise to an investment opportunity.

In fact, policies aimed at promoting venture capital activity have often turned out to be useless, or, at most, entirely unsatisfactory and insufficient. This is mainly due to the inadequacy of their situational context. It is, therefore, necessary to act upon this very same context and put adequate conditions in place to increase the match between the supply and demand of risk capital. This is the only way to make policies of promotion useful and to achieve effective results.

## **6. The main drivers favouring an ideal context for the development of venture capital**

Lastly, the authors identify and briefly describe those drivers that are most important to the development of a venture capital market in Italy.

Before proceeding, it is important to recall a possible weakness of the analysis conducted in this paper. As just mentioned during the definition of the model, it has

been necessary to leave out some variables potentially relevant to an analysis of venture capital activity, since the historical data available for them in the Italian context is either not available or unreliable, such as research and development expenses and know-how [Romain & van Pottelsberghe, 2004], labour market rigidities [Ramon & Marti, 2001], and pension funds efficiency [Jeng & Wells, 2000].

First of all, the formula previously presented in this paper has demonstrated that there are two particularly important drivers in the financial market.

The dynamism of stock markets has been demonstrated as being one particularly important factor (as measured by the annual number of IPOs, Initial Public Offerings), which confirms that having the use of an efficient stock exchange market (well disposed towards the quotation of small to medium-sized enterprises) encourages risk capital investors to widen their activity.

Thus, it would be particularly effective to work hard on increasing the efficiency and attractiveness of the stock exchange market. Finally, it would be important to encourage the use of IPOs as a way out at the end of the investment process, contributing to an increase in the stock exchange market, which could be achieved through specific incentives for newly quoted ventures.

The second key-factor is represented by the number of investors. If investors are not interested in diversifying their activity, then a quantitative and qualitative increase in the supply of risk capital will only take place with an increase in the number of operators. In fact, the number of investors in Italy is lower than in other European countries of comparable economic power and financial markets (such as France and Germany). One must therefore underline the importance of developing new policies and measures to overcome the difficulties in raising funds for new investors towards professional investors (pension funds, insurance companies, foundations), as this greatly throttles the Italian market [Gervasoni, 2007].

Moreover, even if the Italian private equity and venture capital market has reached a significant size, it still has difficulty in fully expressing its potential, in particular with reference to medium-sized enterprises [Chemmanur *et al.*, 2011]. The entrepreneurial class still have many fears about opening their enterprises to investors, including venture capitalists. The most critical areas involve [Bank of Italy, 2009; Aifi, 2003] potential conflicts arising from the requirement of a future sale of the participation by the investor, the approach to assessing the value of the enterprise, the length of the period of cooperation between the entrepreneur and the venture capitalist, and their effective interest in developing the enterprise's activity.

Moreover, on the demand side, when opening up shares in the company to investors, it is necessary to make the company more acceptable by developing its rules of governance and transparency. This aim can be brought about by stepping up the quality of governance and transparency in companies at a national level, which would also have beneficial consequences on the competitiveness of Italian companies internationally. In fact, suitable corporate governance interacting with capital structure may result in value creation [La Rocca, 2005].

The governance imposed by a venture capitalist prepares a company for “systemic capitalism” [Golinelli, 2005]. The interaction between investor and entrepreneur is, in fact, based on rules of governance similar to those demanded by financial markets. These rules bring the interests of various actors in line with the development of the business.

From the supply side, it is important to note that the relation between risk and return in each of the investment stages (early-stage, expansion, buy-out) is not exactly the same in Europe (and, in particular, in Italy) and in the United States. In Europe, start-up financing produces lower returns compared with the other categories of deals [Kraussl, 2007]. On the contrary, in the United States, returns are assigned different risk profiles at each stage, unlike the situation in Italy and Europe, where things appear to be different and contrasting [Marti & Alemany, 2006; Bollazzi, 2007]. In the United States, venture capital investments designed to support start-up enterprises, which are classified as very hazardous, generate regular returns, and the same may be said for development capital and buy-outs.

One must therefore establish whether investors’ expectations of returns are actually consistent with their respective risk profiles, or if they are only a consequence of serious informational asymmetries [Sorrentino, 2002]. Investors’ tendency to focus on later operations in the life cycle of a business (private equity) is due to the higher returns these generate in today’s context compared to venture capital, which is in fact riskier. This reversal of the natural relation between risk and return is symptomatic of a diseased market: if, as is commonly accepted, private equity operations have a lower risk profile compared with venture capital ones, then investors must reduce their expectations of returns, as these are not proportionate to their real risk levels. Informational asymmetries, therefore, still exist in the Italian market, and this is the main reason why limited risk profiles generate extra-returns. A new policy must, therefore, be studied in order to cancel the above informational asymmetries. This condition is fundamental if the final aim is to establish a realistic relation between risk and returns that will allow funds to be redirected to venture capital investments.

## 7. Final reflections and matters for future research

Realising and successfully conducting a virtuous circle for venture capital may therefore help policy-makers re-think the relationships between enterprise and the financial market in the light of the new balances and alignments of interests that focus on the development and competitiveness of the economic system.

Venture capital alone is unlikely to re-launch an economy, however it plays an important role in stabilising development processes and selecting the most suitable players [Jell *et al.*, 2012]. One is, therefore, to reason “systematically”. For sure, the players in this system are the companies, the managerial class, banks, public and private institutions, whose aim is to improve financial markets, and all those able to contribute with innovative and scientific skills and competencies [Perrini, 2010].

Here it is possible to find the link between the microeconomic level (the enterprise) and the macroeconomic one (the economic system). Cooperation between venture capitalists and target companies can be seen at a macroeconomic level as providing the latter with an opportunity to emerge as “market champions”, a fact which may not otherwise have been possible. Hence, it is advantageous to allocate a significant portion of capital to the industrial development of enterprises and by so doing also, indirectly, to the development of our country. In this respect, a crucial role is played by venture capitalists, insofar as they represent the only category among early-stage investors whose organisational characteristics and dimensions enable them to attract the right institutional and financial resources.

Subsequent research in this field should study the different role of each early-stage investor. In fact, there are three different kinds of players: venture capitalists, business angels and enterprise incubators. These players have different roles and attitudes, which is why they develop different kinds of relationship with the new entrepreneur. The role of each particular early-stage investor is very different, mainly due to the fact that each has its own core business and its own core competences, but also because they operate at different stages in the enterprise’s life cycle [Knockaert *et al.*, 2010]. This means that it is possible to find different experiences, different contributions and different relationships between entrepreneurs and early-stage investors. *What are the specific characteristics of the contributions made by each category of early-stage investor?*

It is commonly accepted that the drivers for value creation should not only include financial support for a new venture [Del Pozzo, 2001; Mustilli, 2002; Chemmanur *et al.*, 2011], but also forms of strategic support, so as to identify and create effective strategies and corporate governance schemes. *Is the strategic support provided by different categories of early-stage investors normally of the same kind?*

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