Università
Ca'Foscari
Venezia

Corso di Laurea magistrale
in Amministrazione, Finanza e Controllo

Tesi di Laurea

Ca' Foscari
Dorsoduro 3246
30123 Venezia

The Italian and Chinese private equity industry: challenges, differences and opportunities

Relatore
Prof. Ugo Rigoni

Laureando
Nabil Adl
Matricola 834609

Anno Accademico
2011 / 2012

ACKNOWLEDGEMENTS

I would like to express special gratitude to all the people who have supported me during my studies. Without them it would not have been possible for me to achieve my objectives.

Firstly of all I would like to thank my dissertation supervisor, Prof. Ugo Rigoni, for his useful guidance, understanding and incredible patience. Without his help and support this dissertation would not have been possible.

I owe sincere and earnest thankfulness to my parents Annalisa and Walid for giving me personal and financial support to follow my interests and trying to give their best to pursuit my goals and happiness. There are no words to describe how I immensely appreciate the sacrifices they have made in their whole life for me as well as, in the same way, for my brother and sisters.

Especially thanks to Amir, not only a brother but a landmark on which I rely. Sharing with you all the things I love doing in my life is something incredible. Thank for supporting me to take part in the near future to my first ultra-trail running competition, not only a simply race but something that will make me stronger than ever.

In a world made of opportunism and selfishness, I would also like to thank my friend Stefano for his honesty and fairness demonstrated since our childhood. Thank you for the countless experiences we passed together and make my life incredibly colorful.

For any errors or inadequacies that may remain in this work, for sure, the responsibility is entirely my own.

Nabil Adl

Venice, September, 2012

Dedication

To my family

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF ACRONYMS

AIFI	Associazione Italiana del Private Equity e del Venture Capital
ARDC	American Research and Development Corporation
CAGR	Compound Annual Growth Rate
CAPM	Capital Asset Pricing Model
EBO/WBO	Employee/worker buy out
FBO	Family Buy Out
FDI	Foreign Direct Investment
FIVCIE	Foreign-Invested Venture Capital Enterprises
GDP	Gross Domestic Product
IBO	Institutional buyout
IJV	International Joint Venture
IPO	Initial Public Offering
IRR	Internal Rate of Return
LBO	Leverage Buy Out
MBO/MBI	Management Buy Out/ Management Buy In
M&A	Mergers and Acquisitions
MBO/MBI	Management Buy Out/ Management Buy In
MNE	Multinational Enterprise
MOFCOM	Ministry of Commerce People's Republic of China
PTP	Public to private/ Going private
PIPE	Private Investment in Public Equity
RBO	Reverse Buy Out
R&D	Research and Development
RMB	Renmimbi
SOE	State Owned Enterprise
WOFE	Wholly Owned Foreign Enterprise

1 THE PRIVATE EQUITY INDUSTRY: A GENERAL OVERVIEW

1.1 History of private equity

Private equity has existed since the earliest days of commercial activity as evidenced on Europe by the Spanish monarchy and the Italian investors who financed the expeditions of Christopher Columbus, could be considered, in a sense, private equity investors.

The history of private equity started during the industrial revolution when merchant banks based in Europe, and later in the U.S., financed industrial projects and the building of Transcontinental Railroad. In particular the first operation in history that could be classified as the first true modern buyout deal can be traced back to 1901 when J. Pierpont Morgan bought Andrew Carnegie's American Steel Company for $ 480 million.

This strategy could be identified as a classical buyout in which a company acquires a target in order to increase its market share through operative and financial synergies. Other similar operations were commonly practiced in the early part of the 20th century by wealthy individuals and families such as Rockefellers, Whitneys, Vanderbilts, etc.

Only after the World War II private equity financing became a large-scale industry; the seeds of private equity were planted in the United States with the founding of two leading firms known as American Research and Development Corporation (ARDC) and J.H. Whitney & Company as well as in Europe with the creation of Charterhouse Development Capital (1934) and 3i (1945) in the United Kingdom.

Indeed, private equity and venture capital did not really take off until 1958, when was introduced the first limited partnership, based in Palo Alto, by Draper and Gaither& Anderson. This kind of institutional structure, still in use today, was created for solving problems raised up with closing-end funds in which investment professionals serve as general partners and investors, as passive limited partners, provide the capital to funding the related fund.

In the 1970s and 1980s, this industry registered three boom and boost because it is a highly procyclical activity. Another major contribution to develop private equity as an asset class was the introduction, in 1979, of the Employment Retirement Income

Stabilization Act which allowed, for the first time, pension funds to invest in venture capital and this fact resulted extremely useful for the staggering increase of funds invested and in a faster professionalization of the industry.

The main reason of Private Equity and Venture Capital expansion depends on the investor's desire to optimize its investment returns including the context of its own portfolio risk approach. Even many institutions, as well as many retirement money managers, willing to manage long term savings or pension's assets expecting long term returns.

However, the high returns enjoyed by the leading private equity and venture capital firms in U.S. induced venture capitalists to become active also in other countries seeking opportunities and challenges. This type of investments is by now a sizeable industry in Europe and gradually in Asia. Honestly, this business is really remunerative but, at the same time highly risky. As proof of this, by the end of the 1980s, the excesses of buyouts market began to demonstrate the bankruptcies of several large buyouts firm due to the mirage of quick and easy capital gains.

Then came recession and funds started to restructure their activities and focus on core business trying to achieve a streamlined structure in order to regain profitability. The industry enjoyed another boom cycle between 1992 and 2000 with the emerging of high technology and Internet. In this period many funds had been raised, which were invested at the peak of the dot.com, and just a few were managed by self-assured people new to venture capital.

However this cycle sour in 2000 and the bubble burst so many funds stopped making new investments in order to concentrate their effort in the existing portfolio and reevaluate their investments. Afterwards major buyouts became once again commonly used, especially between 2004 and 2006, due to widely available credit and a unprecedented level of leverage used by a considerable number of funds.

By August 2007, the world financial crisis and the credit crunch, due to mortgage's market crash, affected the private equity investments again which sharply decreased including the Private Investments in Public Equity (PIPE) transactions. In order to provide financial market more guarantees, deals that once required 15% in equity, are going to

involve an average of 35%-40% to make transactions safer and avoid any type of operations that should keep the worldwide economy prospective unsteady.

1.2 Relationship between the private equity industry and company lifetime

The private equity and venture capital industry plays an important role when the entrepreneur realizes its firm needs to be funded by external investors in order to increase the expansion of the company itself. Therefore, equity investments provide to the companies a financial support in order to underpin their different typologies of activities or provide the finances needed to set up a firm.

Every firm need a different amount of funding according the several stages of their lifetime. The drivers that measure the firm's financial need for funding are investment, profitability, cash flow and sales growth. These four variables have to be considered together because they are strictly related and should be evaluated in a long-term prospective because are useful to figure out the stage in which the firm is collocated and also what kind of financial aid is suggested to define their strategy.

The analysis of the four drivers is extremely important to find out which of the following different stages the company is experiencing:

- Development
- Start up
- Early growth
- Rapid growth
- Mature age
- Crisis and/or decline

During the first stage, the entrepreneur has to focus on its business feature, its commitment as well as the business opportunities that could be exploited. The biggest issue is to define the ideal structure for the project's progress and try to make successful investment in productive factors. In this preliminary phase, sales does not exist,

profitability and cash flow are negative due to the initial investment such as legal, fiscal, advisory, engineering costs needed to set up the company.

The start-up stage consists in the company creation and in the launch of the firm activity; sales start even if the profitability and the cash flows are strongly negative affecting the company's financial conditions.

The next step regards the early growth just after the start up. Investments are limited to the inventory financing and profitability, cash flows are still negative but are in better shapes if compared to the ones of the previous step. Sales rise quickly in order to refund the productive factor's costs. However the overall trend is positive and stable and the negative value is gradually becoming greater than zero.

The rapid growth is characterized by a similar situation of the former step but the profitability and cash flows are increasing and the sale growth is positive but decreasing.

During the mature stage the investment are focused on the inventory or working capital and on the replacement of ineffective and unused assets due to sales decreasing and worsening of every kind of company revenues.

In the last phase, identifying the appropriate investment decision to overturn the decline is a daunting task and the other three variables are sharply falling down.

A very closed relationship exists between each stage and financial needs and there are basically two approach which analyze the equity investment stages involving the Private Equity funds and how these ones are linked with the target firm's life cycle.

The traditional approach is characterized by the steps described below:

- Seed financing (development)
- Start-up financing (Start up)
- Early stage financing (early growth)
- Expansion financing (rapid growth)
- Bridge financing (growth implement)
- Replacement financing (mature age)
- Vulture financing (crisis and/or decline)

This approach faithfully illustrates the investor's role and activities implemented to satisfy the firm needs and could be carefully analyzed in each step.

The Seed financing is the first step and is also well known as first round or initial financing because it is necessary for developing the business idea, the future plan and the product not yet created of a new firm. In this phase funded firms do not sell any product so they are unable to earn any kind of revenue. Particularly, the seed financing's purpose consists on transforming R&D projects into successfully business start-ups and in case of funding by financial institutions this phase is useful to create new ventures.

Transforming R&D into business is very uncertain; therefore the risk-return profile is a daunting task to define. There are several variables to calculate such as type of business, kind of product sold, market analysis, competitors, etc. and due to highly risk, seed financing could be divided in pre-seed and seed capital finance.

Pre-seed, also known as "proof of concept", is generally provided from public sources and related to basic research, while seed capital finance is easier and faster to apply.

The Start-up financing has the aim to transform the idea, developed in R&D department, into a real operating company thanks to setting up projects and launch production. The sources of funding are mainly used to purchase equipment, inventory, plants and everything is of primary importance for setting up the company's business operations. Start-up financing represents one of the most difficult phase for a company because it is arduous to know if the market will support the idea and transform it into a successful business as well as support sudden risks that could come out during this process.

During start up financing technical and engineering suggestions are extremely considered and managerial involvement is very limited even if is being created.

Private equity operators and venture capitalists are definitely involved in firm's management due to its easier way to own a larger number of shares and direct the company's decision rather than a later investment when the risk is decreasing.

The Early stage financing represents a bridge between start up and the taking off the real business life cycle. The investors focus their attention in creating a stable and permanent organization necessary for a firm that moves from start up to sales. In particular for financers, this is the step where financing really begins and money is used to sustain the gap between cash flow and money needed. For the first time is possible to revised properly

a business plan and expect an indicative Internal Rate of Return. In order to assist the firm giving a solid and strength support, managerial involvement represents a key factor for strategic decision processes.

The Expansion financing regards the funding of the fastest growth phase of a firm. The main goal consists on consolidating the position on the market even if the company is growing may not reach its break-even point or achieve an initial profitability.

The risk is moderate, obviously linked with the business, because the business trend is already well known and money is used to finance sales growth or to improve/develop projects in strategic fields so risks due to uncertainty decrease rapidly.

The Bridge financing represents a temporary funding that eventually will be replaced by equity investors or debt lenders. This debt financing is usually raised in a short term note within 6-18 months of an anticipated public offering/private placement (IPO), and secondly converted into preferred company stocks.

Usually the lender's convenience is characterized by the right to convert the note into preferred stocks, as told before, at a 20% discount from the preferred stock's price in the next financing round.

The Replacement financing phase, common known as "mature age", begins when the firm becomes more stable (profitability, cash flow) but private equity operators still plays a role of primary importance. In this period the company's needs have been changed so the value drivers are focused on sales development and size increasing.

A crucial point is identified in corporate finance decisions and governance regarding the future's company such as: listing on a stock exchange, substitutions of shareholders or a new design of company governance through IPO, turnaround, LBO, restructuring operations. In this case, Private Equity operators used to buy a large number of shares issued by the target company just to make the whole deal easier to implement even if they do not participate in the major decisions allowing the current top management role in its real functions.

The Vulture financing cover a critical phase for a firm that has to face decline or a crisis period due to strategic issues. In fact, money is used to sustain the strategic or the acquisition processes and funding the financial gap generated from the decline of growth.

Private Equity operators move from a simple financer to an effective consultant activity. In case of financial distressing this kind of operators can offer vulturing finance that consist on restructuring firms enabling financial performance, regain credibility from the market as well as revising and exploiting new businesses opportunities.

Particularly the common successfully typologies of operations for avoiding the crisis are debt restructuring and turnaround where risks is linked to the nature of the crisis and consequently the expected Internal Rate of Return is extremely difficult to calculate.

For investors, vulture financing is very risky with no guarantees of the company's revitalizing. Frequently this type of investment's goal regards the purchasing of senior securities and substitutes the board members of the target company in order to support directly the managerial strategic decision and the implementation of the same.

Afterwards, the modern approach which mainly identifies three different investment categories has been formulated and it has been introduced in order to give a fast and clear representation of the private equity steps:

- Creation financing
- Expansion financing
- Change financing

The first step consists on a financially support to an individual original idea that does not take place due to its restricted amount of money. Furthermore the need of private equity finance emerges when a company is looking for financial support for developing a new product, service or renewing its production process.

The second step regards the expansion financing which include the problems arising during the growth phase and increasing size of a firm. More specifically there are three different paths connected with the growth:

- In house growth path: the project's goal is to improve the sale development plan rather than the production process so the private equity operators are involved in providing the financial sources because the sales plan is already planned
- External growth paths: projects concern M&A deals and the private equity operators try to find their ideal partners and the best target company to invest their financial resources

- Vertical or horizontal integration path: the project's aim is to set-up capable to include operative and complementary firms with similar business, technologies and customers, etc. In this case private equity operators develop the holding's strategies issues in order to achieve the desired outcomes rather than paying attention to fund the structure design (cluster venture).

The last modern approach step regards the changing of the firm's shareholders composition. This phase of company's life cycle is crucial because there is no clear relationship between stage, financial needs, activities like in the traditional approach whereby the firm relies to private equity operators to solve their financial situation.

The modern approach is not really innovative but is a newer, easier and more firm-oriented way to understand how private equity finance basically works. More specifically the mainly finance frame of mind prefer to use the traditional approach due to the clearer and more exhaustive explanation during every investment phase.

1.3 The private equity organization

The typical Private Equity fund's structure is a limited liability partnerships due to the high-risk areas in which this funds operate. The main function is covered by the General Partner whose responsibilities regards the fundraising as well as managing in a profitability way the fund. The common typology of investors [Figure 1] are mainly public and corporate pension funds, insurance, banks endowments, wealthy families and individuals, investment banks and non-financial corporations.

In particular it has to be mentioned that the fund's lifecycle has a fixed life span of 10 years in order to achieve the goals that have been originally set. Usually for investors is extremely difficult to redeem the amount of money they invest in before the end of the fund's lifetime so the private equity investment is definitely considered an illiquid asset.

However, is emerging a secondary market where is possible to sell, before the fund's term, their funds investments to other limited partnerships involved in the transaction. The mainly motivation, behind the buyers strategies in the secondary market, is to realize a

portfolio diversification in terms of age of their funds invested in with the aim to decrease the intrinsic risk. In order to monitor the risk, the investors of real capital has developed advanced financial engineering tools even if a percentage of risk still remain in business activities as is shown from the Capital Asset Pricing Model created by William Sharpe.

Due to the huge risk discounted, there are good reasons to provide an evident flexibility to these funds and a critical factor is maintain under control the agency conflicts that could may arise between the fund manager and the investors. This tension is usually raise up when decisions are driven by the objective to maximize the parent company's profits instead of being oriented in maximize the profits for the fund and its investors.

Consequently an efficient governance structure is fundamental for setting up, manage a fund and prevent any kind of random conflict depending from every investors interests.

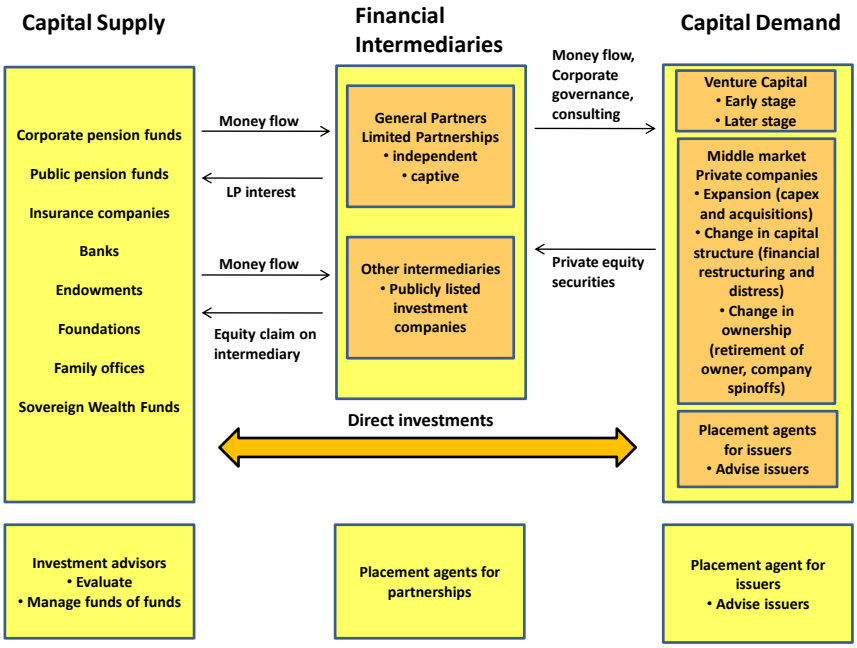

Figure 1: The organization of the private equity market
Source: Caselli S. (2010), Private equity and venture capital in Europe: markets, techniques, and deals

1.4 Private equity funds structure around the world

The Private equity fund's worldwide is characterized by a different structure according to the different past and present economical environment, socio-cultural environment, international environment, political and governmental environment, the legal framework that affect each country.

In US the most used structure for Private Equity funds is a limited partnership regulated from the state of Delaware that take the name of Delaware Limited Partnership. For this typology of partnership is not necessary a registration to any regulatory authority even if has to respect its code of conduct. The fund's management company is usually an independent company registered as an investment advisor.

The Chinese market experienced the private equity and venture capital investments only about twenty years ago. Since the 1990s, the Chinese legal framework made a marked distinction between the domestic law from the foreign law because the latter was subjected under governmental approval. Consequently the onshore Renmimbi funds (China National's currency also abbreviated with the acronym RMB), which raise capital in China, enjoyed a considerable competitive advantage in confront of offshore RMB funds, domiciled in China or elsewhere, that were historically been subjected to strict foreign investment restrictions and foreign exchange restrictions in China. On August 2009, in order to make an end of such legal disparity of treatment, the China's Ministry of Commerce (MOFCOM), promulgated the Partnership Measure Act that finally allow foreign companies to set up limited partnerships within the People's Republic of China developing the steady growth of the private equity and alternative investment sectors.

The mainly Private Equity funds in UK have to be registered in England under the Limited Partnership Act of 1907. Some of these funds are organized in trusts, which invest their savings in securities, and are quoted on the London Stock Exchange PLC. A specific kind of trust is the venture capital which could benefit of tax-free income and capital gains even if the investments are restricted to specific typologies of investments.

The Italian funds are based on closed-end funds, as known as "Fondo Chiuso d'Investimento", managed by a SGR (Società di Gestione del Risparmio). Every fund

must be registered, approved and authorized by the Bank of Italy. According to the relevant law, only qualified investors are allowed to invest in funds. A particular characteristic of this economic entity is the division between asset of the fund and its management company; according to this distinction, the SGR's creditors can not claim against the fund and the investor's creditors could only obtain the shares of the specific investors.

Nowadays in Germany there are two common Private Equity structures: Limited Liability Company (Gesellschaft mit beschränkter Haftung, Gmbh) and Limited Partnership (Kommanditgesellschaft -KG- usually characterized by the presence of a general partner) using both set-up as well as closed-end funds. Its liability is restricted, as a limited company, to the amount of the respective subscriptions.

The French Private equity funds are characterized by the presence of two different structures: FCPR (Fonds Commun de Placement à Risques) and SCR (Sociètè de Capital Risque).

The first type is a joint venture ownership of securities and is not a separate entity able to enter into contracts because is needed the request of the Management Company, which must be registered in France and authorized by the Authoritè des Marchès Financiers (AMF). The only responsibility . The Management Company has to manage the FCPR, including the right to sell and buy shares. FCPR are basically divided in different kind of subtypes depending on the business they may concern (investments in innovation, specific sector, etc.).

The other Private Equity fund's structure, differently from the FCPR, is distinguished by the absence of a management company that is replaced with a board of directors made of one or two managers. Its main goal is to invest the money in a portfolio divided in different kinds of assets. Due to the different types of activities involved, the SCR's legal structure could be formed as a Sociètè per Actions Simplifèe (SAS), Sociètè en Commandite per Actions (SCA) and Sociètè par Actions (SA).

In Netherlands the common fund's structures are divided in three types: Dutch limited liability company, limited partnership, investment or mutual fund. Only the first structure is allowed to be qualified as an investment company (composed of variable

capital) and should be listed at Amsterdam stock exchange. Unlike the Dutch limited liability company, the limited partnership needs at least one managing partner and its investment funds are enable to provide limited liability for their investors.

The most common structure in Switzerland, for domestic Private Equity Funds, is the limited partnership for collective investments in which, at least, one member bears unlimited liability known as general partner. The latter has to be registered in Switzerland, under the Swiss supervisory authority, as a public limited company and could delegate investment decisions to a third party.

1.5 Forms of private equity

Private equity is a form of financing providing capital to non - quoted enterprises on a stock market; It plays an important role as a catalyst for companies involved in improving their performance.

Commonly, Private equity funds use several tools to support companies in achieving their aims and each of them is characterized by a different approach for becoming effective, appropriate as well as well-fitting in a particular moment of the company's lifecycle. Anyway, for every stage different private equity funds are raised by General Partners who are specialized in specifically private equity market segments.

1.5.1 Buyouts

Represent the most common technique, used by Private equity funds, to purchase a target company's shares in order to acquire the management control and direct the strategies. As known as corporate restructuring, takeover of company's assets, buyouts is basically accomplished by borrowed money or issuing more stocks [Figure 2]. It is also seen as one of the fastest way to implement the company's market share, developing competitive advantage in a specific area and align itself with the other own companies working in the same or similar sector.

Unlike the venture capital transactions, buyouts wok in a totally different way: the stage of their investments are focused in mature companies and not young and emerging ones, broad coverage of the economy instead of investing in technology and innovative start ups. They are also different with regard to financing and control of investments: leverage transaction despite of venture capital unleveraged operations, usually (except acquiring minority stakes in public companies through PIPE) involve a change of control and not only the acquiring of minority stake.

1.5.1.1 Subtypes of Buyouts

Buyouts are normally divided in different subtypes of operations [Figure 3] based on the characteristics of the economic entity that will manage the company:

- Management buy-out (MBO): managers/executives of a company purchasing controlling from existing shareholders expecting to rose rapidly the business if it controls the ownership.
- Management buy-in (MBI): purchasing a company by outside investors which substitute the board of directors believing to generate a greater value than the current yelds.
- Buy-in management buy-out (BIMBO): basically a compromise between MBO and MBI. Almost retaining the continuity of current management and join some key managers with a specialized capability to raise more funding.
- Employee or worker buy out (EBO/ WBO): an alternative to leveraged buyout indicated for small or branches/subsidiaries of affirmed companies in a solid situation or in a significant financial distress. Basically, employees buy a majority stake in the firm they work for.
- Family buy-out (FBO): support the acquisition of a target company by one of more member's family owner.
- Institutional buy-out (IBO): a takeover of a company made of a financial institution which essentially support a group of managers who will run it.

- Public to private/ Going private (PTP): a transaction that convert a publicly traded company into a private entity and consequently its shareholders are not able to trade their stocks in the open market anymore. Commonly Private equity funds purchase a company close to bankruptcy so this transaction generally involve a significant amount of debt to restructure it prior to become a public corporation once again.
- Reverse buy-out (RBO): typically used for companies to obtain cash for reducing their debt as a method to make more flexible the manageable levels. In this stage the company who is willing his operation, have serious difficult to repay the debt used from the previous leveraged buy out and wishes to rise quickly the amount of capital desired.

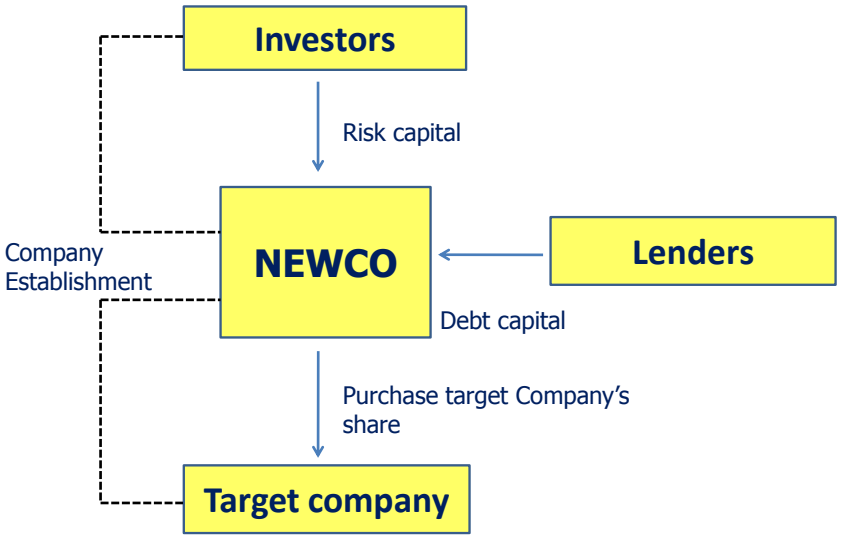

Figure 2: Typical scheme of a Leveraged buy out operation
Source: Cornelius P. (2011), International investments in private equity: asset allocation, markets, and industry structure

1.5.2 Venture Capital

When companies are trying to expand and seek growth capital, venture capital should be the best option in order to taking off the new business. This form is designed to provide funding for start up companies or for a project. Nevertheless, venture capital is increasingly importance for entrepreneurial venture in both industrialized and developing countries for creating innovative and high-technology businesses.

A particular difference, worth to be mentioned, regards venture capital and angel investing. The angel investor, usually a wealth individual, fund the new company before the venture capitalist's aid. Actually, this is the first source of funding and the risk supported, from the angel investor, is really high and the probability of failure is concrete even if its financial amount is not so considerable comparing with venture capital.

Likewise angel investing, venture capital is even so highly risky but at the same time could be quite lucrative.

1.5.3 Turnaround

A financial recovery of a company that shows poor performing for an extended period of time and with negative forecast economic prevision in which revenues do not cover costs and the presence of the following situation: difficult in paying creditors, layoffs, significant decline in stock price, etc.

The private equity fund's aim consists on identifying the problems of the target company, through a problem-solving strategy, and focus on its key factors in order to enhance a market competiveness.

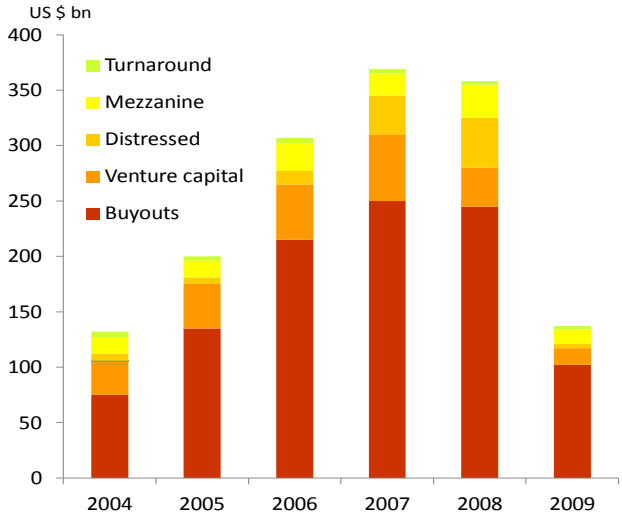

Figure 3: Global fund-raising in different private equity categories
Source: PREQIN

1.5.4 Distressed

When a company incurs in a critical financial situation due to the difficulty to pay off the obligations to its creditors. Moreover the financial distress is needed when a company present high fixed costs, illiquid assets as well as revenues steadily decrease. Normally, in this stage, the costs borrowing of additional capital raising sharply and, is some case, the chance of bankruptcy become concrete.

Likewise turnaround operation, financial distressed involves private equity operators willing to invest in declining companies whose securities are trading at substantial discounts in anticipation of a possible default trying to re-establish prosperity.

1.5.5 Mezzanine

Regards unsecured debt sitting between the equity and senior layers of a buyout structure used to finance the company expansion. Besides this financial phase is immediately prior to a company's IPO and the investors, taking part in this financial stage, assume lower risk of loss than the investors who invested in an earlier round. This

typology of financing is definitely aggressive so the expected internal rate of return is one of the highest during the company's lifecycle.

1.6 Common method to measure private equity performance

Private equity funds performance should be realistic and accurately measured only at the end of their life (usually around 10-12 years) when the investments are realized. Consequently the valuation of ongoing private equity investments are, without any doubt, imprecise because capital committed is continuously provided by investors during the whole fund life.

Private equity returns could be expressed through several method typologies. The most widely used measure of PE funds performance is the Internal Rate of Return (IRR). The calculation of the IRR, usually done per vintage year, takes into consideration several factors such as timing of cash contributions and distributions to and from the partnership and the length of time an investment had been held.

Moreover, this discount rate makes the net present value of the whole cash flows obtained from a specific investment equal to zero:

$$\sum_{i=0}^{T} cf_i(1 + IRR)^{-1} = 0$$

where T is the lifetime of the fund and cfi is the cash flow accrued during the period t (IRR[CF]). Furthermore IRRs are calculated for the median, upper and lower quartile funds which provides useful information concerning the distributions of return among the funds. Besides a single fund, exist pooled IRRs which are calculated by combining the cash flows of all funds like a huge fund.

Even if this evaluation method is the most common performance indicator, it shows different point of weakness that are described below. First of all, it assumes that the interim cash flow generated by investment is reinvested at an interest equal to the IRR. Secondly, the timing of underlying cash flows could be overestimated, sometimes very significantly, comparing with the final return of the whole investment.

The pattern of cash flows is definitely different from a "buy-and-hold" strategy of the public equities. Another suitable approach to evaluate fund's performance is the Money Multiple which underlines the simple comparison between capital returned to investor and his invested capital without considering the time of the investment period as it shown below:

$$\text{Realization mutiple} = \frac{\text{Cumulative Distributed Returns}}{\text{Paid} - \text{In Capital}}$$

More in detail, an MM of 1 means that the private equity fund maintain its capital and an MM of 2 means the capital is doubled, etc.

A further measure of performance deserved to be mentioned is the Profitability Index (PI) that compare the present value of the cash flows received by investors divided by the present value of the capital paid by investors

This index could be expressed in different ways: the most common ways report the total amount distributed to investors as a percentage of paid-in capital, known as Distributed to pay-in (DPI), the Residual Value to Pay-in capital (RVPI) and finally the Total Value to Pay-in (TVPI) which is the sum of DPI and RVPI. The upon methods are usually net-of-fees and carried interest. It is also possible to obtain the Profitability Index indicating the performance of the comparable public market investments and which is known as Public Market Equivalent (PME) return:

$$\text{PME} = \sum_{t=1}^{t=T} cf_t \prod_{i=t+1}^{T} (1 + R_{it}) \,/\, \prod_{t=1}^{T} (1 + R_{it})$$

where Rit is the net return on the public market index to which the investment is compared during period t, and cft are the intermediate cash flows obtained and reinvested a in the public bench mark.

Therefore, a PME higher than one basically indicates that the investment carried out by the Private equity funds outperforms the alternative offered by the public market, providing the LPs a sensible measure of their return investment.

1.6.1 J curve

The J Curve illustrates the pattern expected from an investment undertaken by the private equity funds to deliver negative returns and cash flows in the early years of the commitment followed by investment gains and positive cash flows during the fund's mature age till it's end characterized by the exit process.

The shape of the J Curve is influenced by several factors, in particular by two key drivers: the level of fees and the early investment losses.

The management fees are based on the entire committed capital while this capital is gradually invested over the years trying to seek the best opportunities offered by the market. The early investment losses (also known as write-downs), mainly affect the venture capital industry because of the high risky they discount so some of those operations do not meet the investors expectation and underperform reporting losses for just a small amount of money (around one third) of the total investment allocation.

Another important factor able to modify the shape of the J Curve is the time of the investments and disinvestments: the sooner fund managers invest capital in their activities, the steeper becomes the J Curve. At the contrary, the longer the investors wait for taking a decision, the longer and deeper appear the J Curve.

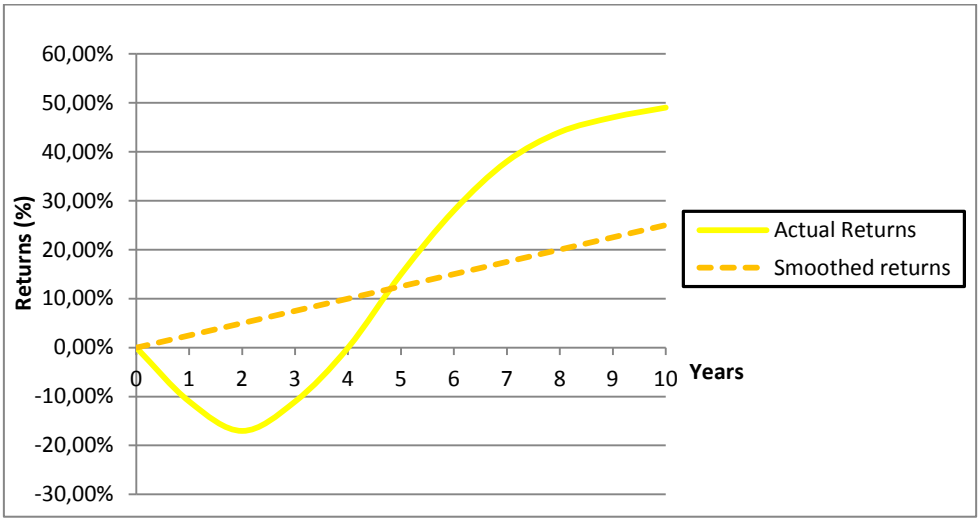

Figure 4: The J Curve effect
Source: Hypothetical example of J Curve

As it shown by this hypothetical graph [Figure 4], a private equity fund will initially show a negative return but when the first realizations become concrete the Internal Rate of Return begin to rise sharply comparing with the smoothed returns of typical investment where investors wish to gain a profit as soon as possible without supporting any loss. Due to the several kind of private equity investments, the returns cover different span of time: usually 2-3 years for buyout funds and generally 3-4 years in case of venture capital and development capital funds.

However, there are some instruments, used as a strategy or a different investment program, capable to mitigate the J Curve late distributions even if there are no guarantees to decrease the drawdown of capital or to improve the returns in the early years of the commitment.

One method consist in making annual commitments to private equity in order to create a diversified portfolio in vintage years and will incorporate, over time, funds composed of different stages of the private equity lifecycle. In this case is possible to incorporate early returns by shifting some of the later gains to the earlier returns consequently a steady oriented program might moderates the investor's exposure to a fast

and large commitment of funds undertaken in a single year, lessening the percentage of underperforming or to have a particularly deep J Curve.

As suggested by Goldman's Sachs Private Equity Group, another common method is used mainly by private equity as well as mezzanine and distressed secondary funds commitments that are oriented on purchasing specialized funds characterized by shorter investment lifecycles which commitments are easily to be acquired.

Regarding the J Curve is necessary to distinguish primary and secondary commitments. The manager in primary private equity funds makes direct investment on behalf of the fund for a period of three to five years and realized the investment distributed to the fund's investors after five to seven years.

In case of secondary commitments, the investors purchase the private equity investment carried on from the original investor (the primary one) who is looking for an exit before the fund's termination in order to gain a profit.

During this essay the attention is mainly focused on primary funds consequently is worth to spend just some words about the secondary funds. Once the investors acquire the primary funds, do not assume any kind of responsibility commitments of the seller so the new owners start their business with a immediate net asset values. In contrast to primary commitments, the distribution of the J Curve is normally abbreviated and the expected cash flows are easier reached from the secondary investors because capital is more quickly drawn down or completely funded to acquire the assets.

1.7 Private equity in diversified investment portfolios: managing and monitoring the dynamic risk

The development of a diversified investment portfolios in private equity funds, needed to decrease the risk supported, is mainly characterized by the presence of two steps.

The first one is based on diversify its business with the acquisition of share of capital desired in different asset classes such as real estate, emerging and mature markets, financial markets. The latter step, assigns the determinate amount of money to invest in

every single market segment identified, once the overall asset mix in the previous step is defined.

The roots behind this way of structure the private equity funds belongs to the econometric models, developed by Harry Markowitz in 1952, as well as the Capital Asset Pricing Model, created by Treynor (1962) and Sharpe (1964), which is widely used worldwide as the general framework for investments.

Both models are oriented on maximize the investments yields diversifying the intrinsic risk they discount as is shown in Markowitz's work named Portfolio Selection: efficient diversification of investments (1959).

However, the specific risk, even if is carefully managed, in any case could not be deleted and still remains in a minimal percentage. Moreover, managing the risk is a daunting task because small changes in input variables means large ones in the portfolio weights which are able to compromise the financial equilibrium.

As it shown from several academic studies, measuring market risk in Private Equity is based on CAPM model, like is previously stated, which consider the risk of an asset equivalent to its Beta.

The Beta risk is also known as systematic risk or nondiversifiable risk and reflects the covariance of an asset's return with the returns on the overall portfolio. Basically the differences underlined in the average returns of different assets might be almost explained by differences in their Betas. Commonly, the CAPM is expressed as below:

$$\frac{[E(R_i)-R_f]}{\beta_i} = E(R_m) - R_f$$

where $E(R_i)$ represents the expect rate of return for asset i, R_f is the risk-free regarding borrowing and lending, and (R_m) is the return of the entire market portfolio. The difference between the expected market rate of return and the risk-free rate of return, E(Rm)-Rf (also known as market premium), point out the extra-return of this investment in confront of the average market rate of return.

Finally, Beta is the sensitivity of the expect level of risk for asset i, and could be delivered as follows:

$$\beta_i = \frac{Cov(R_i,R_m)}{Var(R_m)}$$

Notwithstanding the CAPM is the most influent model for valuating investment decisions, as it shown from the recent financial crisis, began in August 2007, the latter had been underestimated by the managers due to the focus on stale prices without considering the dynamic risk.

Accordingly with Spence (2009) argue, the CAPM has a huge limit because is not able to handle the dynamic risk so this typology of standard asset allocation model is essentially stationary.

The major attention regards the systemic risk which usually take place infrequently as well as been unpredictable, but when they happen losses could be havoc with a consequent increasing of capital calls, through the bond markets, and collaterals instruments in order to supply the lack of liquidity the investors are facing and borrowing liquidity affects the leverage and increase the portfolio risk profile.

In conclusion, the presence of systemic risk requires changes within the investor's risk budgeting enable to structure the portfolio into several risk exposures. In particular the Private Equity market, considered as an asset class, is mainly exposed to illiquid investments and so it would be more appropriate to hold a complementary part of their portfolios in liquid assets to avoid cash-flow distress and provide enough flexibility for adjusting their asset allocation.

2 PRIVATE EQUITY IN ITALY

2.1 Introduction

The aim of this chapter is to provide a deep and detailed analysis of the equity investments carried out by the private equity operators within the Italian market.

In the first section is appropriate to give a brief overview of the main features regulating the entire European financial framework being Italy a part of it. Even though the major part of the European countries are in line with directives allowing LBOs transactions, Italy experienced a contrasting frame of mind concerning their legality or not as has been shown by the several domestic corporate governance law that came into force between the 1999 and 2004. Nowadays, the legal status of LBOs transactions is substantially admitted by the Italian law, under the respect of a specific set of requirements, even if unresolved issues are still debated. As far as this deals were uncertain or even prohibited within the Italian legal environment, in this chapter is deeply explained how the lack of coherent and straightforward frame of mind, regarding the LBOs admissions, limited a further international integration of the Italian private equity market with the most developed countries such as USA and United Kingdom, losing in this way a considerable competitive advantage. Consequently, the Italian private equity market potential might have grown faster and have involved a higher number of domestic investors as well as foreign ones as has been testified by the high net Internal Rate of Return generated.

In the second section a particular attention is paid on how the private equity processes (fundraising, investment and disinvestment) are linked each other and often influenced by the some economical factors (such as the real gross domestic product, the Compound annual growth rate, the inflation rate, the unemployment rate, etc.) as well as endogenous and exogenous macroeconomic variables capable to strongly modify the domestic economical situation. Regarding the shaping of the private equity operation types, a crucial role is played by the global financial crisis affecting the industrialized economies since the 2007 that is still ongoing and by the continuous growth of the

emerging markets through a progressive process of international integration which sounds like a threat for the development economies like Italy. Therefore is being recording an increasing of turnaround and replacement operations to relaunch underperforming companies or conducting company bailouts that otherwise would have failed, although the Italian market is still experiencing unsuccessful investments known as write off.

In the third and last section are proposed several empirical business cases providing a general overview of how the actors involved in these deals define the appropriate strategies to improve the target performances through specific interventions during the different stages the companies are experiencing such as early stage, expansion, buyout and turnaround.

2.2 A brief overview of the European context

Over the last thirty years the private equity buyout funds have become responsible for a larger and increasing quantity of investments in the global economy then, at a first glance, is desirable to understand the possible impact on the fund's structure throughout Europe, which represent the world's second oldest and largest market. Each European country is characterized by a different economic structure due to historical, environmental and social reasons; consequently it has assumed various shapes the ones of the regions where the economy welfare is concentrated within the national market to which is strictly linked.

However, private equity is considered a financial activity and for this reason must be supervised according to EU rules that basically regulate the whole European financial system. In addition, each country has to comply to its own laws in order to gain the minimum requirements for going public even if the internationalization of private equity investment is rose sharply. Consequently is necessary to define a trade-off between domestic and international regulations for removing any obstacle that could potentially obstruct the investments flows and make them easier and safer for investors who are seeking business opportunities abroad.

In these last ten years this process is currently being in act and the investments, largely composed of local investors, are becoming more international enhancing a significant supply of funds from institutional investors such as pensions, mutual funds as well as insurance companies. There are numerous factors that drive this type of transactions and the main one is represented by the investor's eager to focus on high-return projects.

Other factors that have increased the internationalization of the private equity market have been the creation of a extended network of contact and also the existence of cultural links which direct these investment flows. The creation of a better business environment, abolishing barriers, a deeper financial market and high-end human capital represent some point of strengths to attract foreign capital.

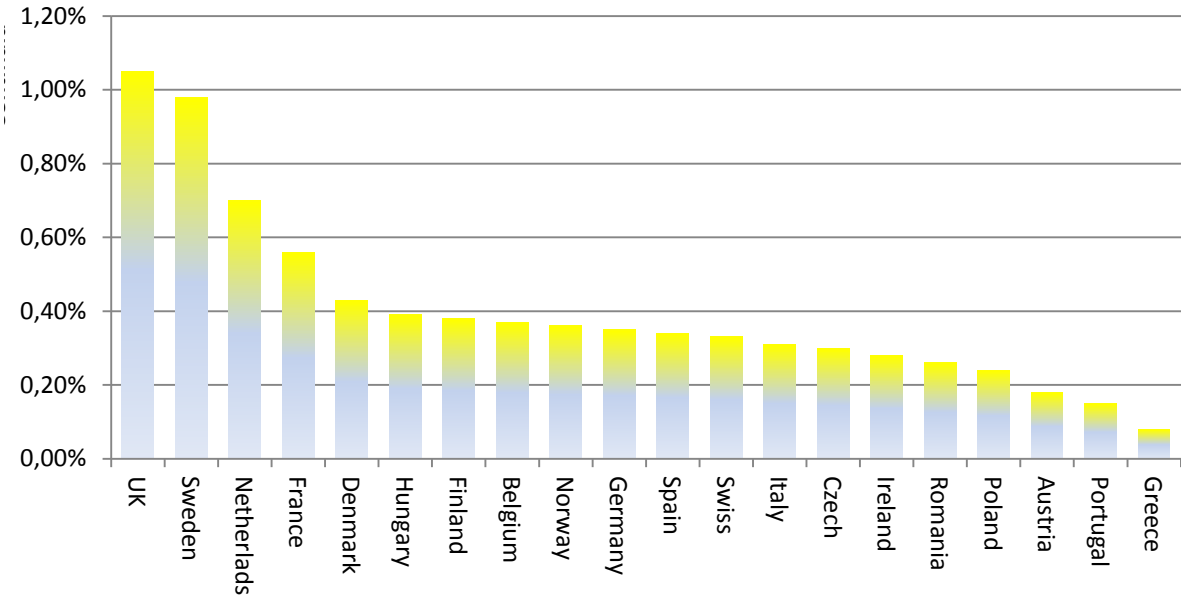

Figure 5: Private Equity investments in Europe (expressed in percent of GDP, 2004-2008)
Source: EVCA

Furthermore, European countries with a limited domestic supply of funds -such as Czech, Ireland, Poland, Austria, etc.- have also tried to attract broad capital by promoting different kinds of entrepreneurships initiative and developing their financial market to

allow suitable exit opportunities to investors [Figure 5]. The last but not the least factors are the M&A transactions and the introduction of the common currency also known as Euro. The M&A activities have grown faster and play an important role to integrate the private equity market as well as diversifying the sector involved in the investments strategies.

According to Petroulas (2007) analysis, the introduction of the Euro increased inward foreign direct investments (FDI) flows by approximately the 15% within the common currency area. Besides, Euro eliminates foreign exchange risk in cross-border investments facilitating the financing of deals.

Overall, European Private Equity and Venture Capital Association studies demonstrate that private equity operations are becoming more integrated thanks to the introduction of several set of rules and actions, described in the current chapter, in line with the international investor's requests.

2.3 Private equity and venture capital in Italy

The evolution of the Private Equity market in Italy has been influenced by some changes that took place in the domestic corporate governance law especially between 1999 and 2004, as shows by the chart reported below [Figure 6]. A particular attention is paid to the leveraged buy-outs deals which represent the 60%-65% of the target value operations in the domestic market, according to Capizzi (2005) and Ferrari (2007) studies. Leveraged buyouts have always been of primary importance within Italian Private Equity market, especially during the 1990s, when this kind of extraordinary financial operations rose sharply due to the favorable economic context.

Afterwards, the evolution of the LBO followed a puzzling trend probably depended by the several laws regulations that came into force over this years due to the strongly criticism that raised against it. In particular, this legal controversies began in the 1990s because part of the Italian scholars (doctrine) on one hand, and courts (jurisprudence) on the other hand, consider that private equity funds contribute to the weakening of the target

companies and responsible for cutting, slashing jobs as well as invigorating the economy and paying a extremely low tax rate compared with the highly-rate return investments.

Therefore, in 2000 the Supreme Court claimed the illegality of LBOs in Italy through the law 5503/2000 which prohibited investors to undertake them. Despite of the Supreme Court deemed the illegality, LBOs did not disappear from the market even if a strong decreasing is definitely perceived. Subsequently, by October 2001, the Italian Parliament approved the Delegate Law 366/2001 which re-introduced its validity overruling the previous decision taken by the Supreme Court. In April 2002, a criminal law reform was introduced in order to regulate the private equity market with the aim of making every single deal clear and respectful of the Italian commercial and criminal law framework. First of all, this reform introduced new crimes applicable in the following cases: acquisition of the target company damaging its equity value and consequently the stakeholders interests, affecting negatively the creditor's interests through the merger between the Newco and the target.

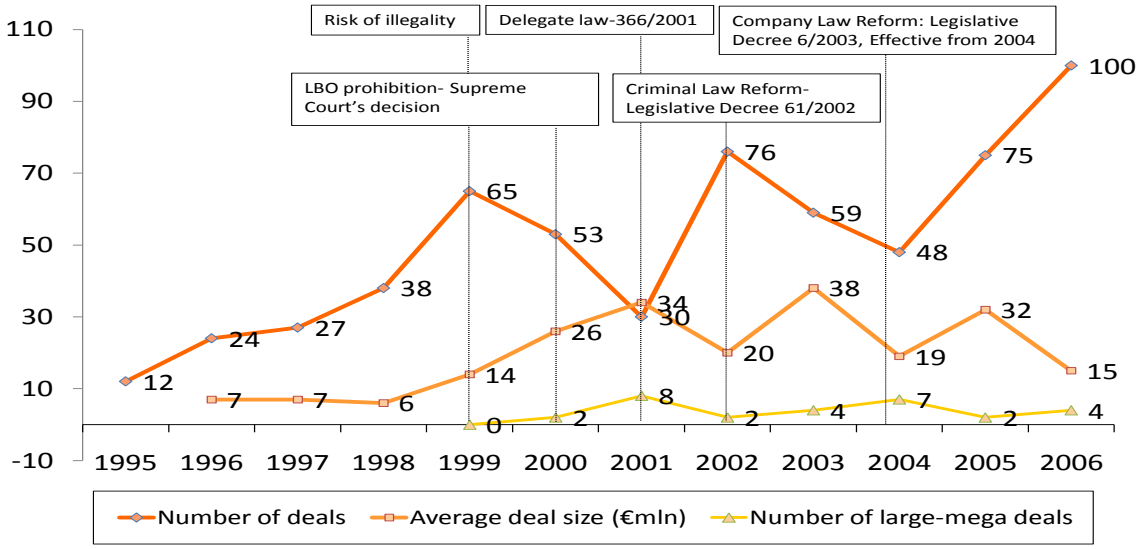

Figure 6: The Puzzling Evolution of the LBO Market in Comparison with Its Regulatory Changes over the Period 1995-2006
Source: AIFI Yearbook, various years; Zambelli (2008)

Through the introduction of several legal prosecutions as it listed on the Italian Civil Code, this criminal law reform focuses on the consequences of punishing the bankruptcy and insolvency caused by the excess of leveraging that may increase the risk of a potential company default. The first articles, worth to be mentioned, are the 2621 and 2622 regarding almost the same subject inherent the *False corporate communications to the damage of members or creditors* take place from the directors, general managers, liquidators and auditors willing to deceive the members or the public investors for obtaining an unjust profit. These actions are intended to cause corporate patrimonial damage, communicate information not correspond to the truth or omit communications required by the law concerning economic, asset or financial status of the company or the group of belonging so to induce in error the destinees of such communications.

These behavior, banned by the Italian law, are punished from six months to three years imprisonment and from two till six years in case of the deception is extended to investors that cover the 0,1‰ of the entire Italian population, according to the last ISTAT census, or the fraud reach the 0,1‰ of the Italian GDP.

The *2628* regards *The Illicit operations on the stock or capital shares or of the controlling Company*, which mainly involve the directors that could be punished with a sentence of one-year imprisonment due to their aim of pursuing own interests and consequently deteriorating the target's share capital.

The second one, art *2629*, regards *the transactions that may prejudice the creditors* in case of damaging the preexisting creditors by implementing an LBO or a merger, arrange the reduction of the capital, without respecting the Italian law regulation. In particular is expected a punishment from six months to three years imprisonment, subject the specific request by the damaged parties, for those people who play a crucial role within the company such as directors, general managers, auditors and liquidators that intentionally tried to deteriorate the company financial situation. This article is also composed of a related part named *Omitted communication of conflicts of interests* (art 2929 bis) which also punish the key figures that might receive a substantial economic advantage for conducting unfair behaviors in order to pursue their own interests.

Another fundamental subject is the art *2634*, entitled *Unfaithfulness on assets* due to a conflict of interest within the company are also punished with the same way of the previous article. Moreover, having a conflict of interest means procuring an unjust profit or other advantage to themselves or to others intentionally causing to the company a patrimonial damage.

The art 2635, named *Infidelities due to the granting or promising of benefits*, is directed to whom perform or omit acts in violations of disclosure corporate data, inherent their professional duty, for having received a promise or obtained illegal benefits causing within company patrimonial damage are punished with imprisonment up to three years.

The last but not least of the major articles dealing with the criminal law reform is the 2637 entitled *Insider Trading*. This article is also directed to the directors, general managers, auditors and liquidators that spread false information, simulated transactions or other devices specifically suitable for significant modifying the prices of non listed financial instruments or to affect the stability of banks or banking groups with those forbidden operations are punished with imprisonment from one to five years.

Previously the Supreme Court stated for a while the uncertain legitimacy of the leveraged buyouts operations, the investor's had not been waited through the set up of a multilayered buyout deal in order to elude the transaction transparency and legal dispute, especially in the form of large-mega deals (investments between € 150 million and € 300 million are known as large deal and over € 300 million as mega deal). This kind of deal [Figure 7] is characterized by a pyramidal structure where the first holding company Newco (1) is located abroad under the law of the country in which is settled up, with the only purpose of creating a second firm, known as Newco 2, based in Italy and fully funded by the main Newco. The acquisition of Newco 2 is possible thanks to the debt financing D1 contracted by the Newco 1 and transferred in a second time to Newco 2 in two different ways: high share premium or through a noninterest-bearing loan. Consequently Newco 2 represent the common vehicle used for purchasing the majority equity stake in the target company. Once the merger is completed, Newco 2 arrange a deal with Newco 1 for reimburse the original debt contracted for acquiring the target company. According to

Silvestri (2005) frame of mind, exist another LBO structure created to minimize the risk of potential illegality declaration from the Supreme Court.

This type of structure is based on a short term bridge financing between the Newco and the target company, which is secured by the buyer's shareholders. Subsequently the acquisition, the Newco and target merge into a new company that receive a new medium-long term loan and serves to payoff the original debt contracted by the original Newco.

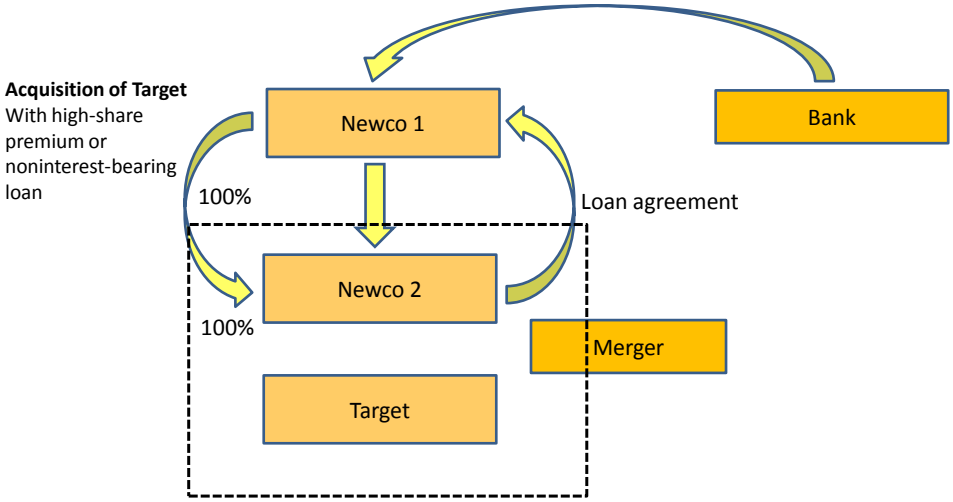

Figure 7: Multilayered Buyout Deal
Source: Zambelli (2008)

Through the combining of the criminal law reform and the new LBO reform mentioned on art 2501-bis/2004, directors might be considered liable whether the merger procedures are respecting the rules even if the risk of a bankruptcy accusation still remain.

Due to jurisprudence hiatus, there are some questions about the LBO legitimacy that are currently unresolved and continuously debated.

2.4 Unresolved issues about LBOs legitimacy

Despite the adoption of a complex structure the illegality risk, in some cases, still remain so a new reform was necessary to better qualify the admission of the LBOs in the Italian market. The turning point of the buyout industry in Italy happened in 2004 with the Corporate law reform (Legislative Decree 6/2003) introduction which preferred the abandon of a multilayered buyout structure on behalf of the common buyout deal.

The reform's aim consist on growing the buyout market in terms of number of deals, which highly increased of 208% from 48 in 2004 to 100 in 2006, as well as number of investors and financial institutions involved in this particular typology of private equity that passed in the same years from 30 to 54 deals with a growth of 80%. Even if the LBOs are definitely approved from the Italian Parliament, several issues still remain debated regarding the legal restriction that might affect the validity of some types of particular buyouts.

The legal status of LBOs transactions are substantially admitted by the Italian Government under the respect of a specific set of requirements, commonly known as contingent legalization. The latter are oriented on the observe of certain conditions that should be fulfilled for gaining credibility such as a reasonable business plan, information disclosure, fair deal certification etc. The main reason why these requirements are introduced regard the spread of prodromal acts against the target's stakeholders, minority shareholders, preexisting creditors as well as any individual that might be unjustly damaged by the transaction.

According with art 2501-bis, the legitimacy is deemed valid under the submission of specific conditions as follows: 1) the merger between the newco and the target observe the absence of specific guarantees consequently, in case of the target default, the lender could not benefit from any priority for a specific target's asset, 2) a clear and understandable disclosure regarding the business reason, the objectives, the funding, the entrepreneurial reasons justifying the transaction, the expected cash flows needed for satisfy the company obligations towards the creditors, 3) an auditing report, made of an independent financial expert to attest the fairness of the whole transaction plan.

However, the discussion concerning the legality of LBOs is not over especially when the issue is focused on the director's liability in case of bankruptcy of the target. As previously mentioned, the art 2501-bis states that "the board of directors has to write a merger plan showing the entrepreneurial reasons justifying the transaction" even if the law does not explain what "business reason" is retained valid nor providing general guidelines with an exhaustive list of LBOs deals admitted.

During the past decade, criticisms on LBOs also rise against the reverse merger (the target company is the only one that still remains after the merger) because this technique might be seen as a violation of the financial assistance prohibition or as an indirect procedure used by the target to acquire its own shares even if the law did not clearly explain the admission of forward or reverse buyouts.

In conclusion, the latest LBOs regulation (Legislative Decree 6/2003, applicable as of January 1, 2004) admits this typology of transaction under specific conditions thanks to the reversed burden of proof which states that the LBOs are legal unless otherwise proven as well as demonstrate the concrete interest in undertaking this operation as proof of "good faith".

2.5 The impact on the private equity market caused by the corporate law reform introduction (2004)

The new Corporate Law Reform has radically changed the trend of the buyout's market and the investor's point of view concerning the deal's structure, the governance of the target firms and the due diligence analysis. In order to underline and figure it out for which reason the quickly rising of these transaction take place, is necessary to divide the recent Italian buyout history in mainly three period. The first started on January 1999 till September 2001, known as Dark period because of the highly debated or even prohibited LBOs deals, the second began on October 2001 and ended on December 2003, could be dubbed Hope period thanks with the main regulatory changes that have taken the Italian Parliament close to announce the intention to legalize the LBOs. The latter, started on

January 2004 and still ongoing, is called Sun Period because these transactions are finally admitted, under specific conditions, and represent the turning point for the whole Italian private equity industry, so clearly becomes the most relevant object of analysis.

The impact on the Buyout market significantly increased after the 2004 Corporate Law Reform moving from the 19 deals (54%) belonging on the Dark period to even 57 deals, corresponding on 73%, just a couple of years after the Reform. The most unusual data is featured by the stable decreasing of buyouts transactions carried out by banks subsidiaries from 42% under the Dark period to barely 16% on July 2006 in comparison with the deals undertaken by independent private equity funds which rose sharply from the 58% to 84% during the same span of time.

Once the LBOs were admitted, the impact on the Deal-Structure register a positive tendency in terms of involvement of the funds through a direct control rights over the target firm. For the first time the private equity firms became actively involved in the management of their controlled entity due to the safer legal environment created by the new Reform without risking anymore the violation of the law and the relative consequences that might bring the top management of the fund punished with imprisonment. Consequently, the amount of money invested in these typologies of transactions doubles from the Dark to the Sun period (from 25% to 51%) as well as the average equity stake purchased by the investors.

The impact on the Governance of the acquired company totally changed: the investors busily participate on the board of directors and also on the right of replace the target's chairman due to the willing of actively monitoring their investment and the work in progress in order to create a value-added within the target company. As far as this deals were uncertain or even prohibited within the Italian legal environment, the involvement in the target's board of directors was around the 47% of the whole participations comparing with a 82% after the came into force of the new Reform. As we know from the Italian Commercial law, 47% is a fewer less than the 50%, plus one vote, that automatically gives the board member's the right to greatly influence the main decisions regarding the company's operative strategies.

Another positive aspect affecting the LBOs transactions regard the involvement of a wide use of financial instruments such as convertible securities that allow the holder to convert the bond into shares or common stocks in the issuing company at an agreed-upon price. In this case, it is useful if the market price of a convertible debenture never drop its intrinsic value (at the money) or even better whether the conversion price is lower than the Equity price (in the money). The most common convertible securities used by the investors include convertible preferred stocks, mandatory convertibles, contingent convertible, mandatory exchangeable, reverse convertible securities, going-public bonds, vanilla convertible bonds, hybrid bonds etc.

According to Kaplan and Strömberg analysis (2009), the convertible securities are focused on minimizing the information asymmetry, a blend of adverse selection and moral hazard, between the investors and the target firm in order to reduce the conflict of interests trough the two parts and improve the new company performance. Adopting these financial instruments is usually associated with a more effective risk management of the acquired company due to the investors willingness of taking part in the governance of the target firm and improve its value-added.

The last but not least aspect is focused on the due diligence procedures that play a relevant role for investors before making investment decisions and is ordinarily guided by a set of general principles, that should take into account for having a successful performance. These selection criteria are the past performance as a possible predictor for its future trend, the experience acquired through a learning process by the fund manager, the access to deal flow thanks to the fund manager's skills to receive asymmetric information and the diseconomies of scale because newly raised funds result inversely related to the increase in fund size between the prior and the present one.

2.6 Fundraising in Italy

The process of fundraising for private equity funds represent a fundamental phase for obtaining the desired amount of money needed to undertake determined investments.

Finding an appropriate and efficacious strategy of fundraising is one of the first signals to understand whether the fund is intended to have success or meet the investor's disagreement. Usually, the winning strategy experienced by these funds depends on several factors like the general partners competences, backgrounds in terms of reputation and renown of in such operations as well as having an excellent network of advisors enabling to cover professionally the different facets of technical, tax, legal aspects in order to reduce every point of uncertainty that might confuse the investor's decisions. In the meanwhile the fund is being structured, is necessary to prepare a placement memorandum which represent a sort of business plan: it clearly reveals the first and last source of success to raise the amount of money needed such as a calling card for a businessman.

According to Gompers and Lerner studies, a detailed placement memorandum preliminary have to include the whole terms and conditions regarding the following information: dimension of the fund, dimension of the participation shares, fund length, strategy to distribute the profit, entity and structure of the management fees, fund's organization and structure costs, reporting for investors, etc.

Secondly, the memorandum should contain quantitative data regarding the past performances of the fund, managed by the general partners, and compared with the competitors. Every previous managed fund have to list the period and the cost of each investment, the performance obtained in term of internal rate of return, types of investment such as management buyout, expansion, turnaround, specific sectors/areas experienced by the fund, etc.

The third and last point to take under consideration is the social environment referred as the set of regulations into force within the country where the fund is aimed to be constituted. Consequently is appropriate to describe in detail the economic variables that affect the country to set up the fund and, thereafter, the macroeconomic conditions.

2.6.1 Macroeconomic variables capable to modify the fundraising process

The Italian fundraising is strictly linked with relevant variables capable to greatly influence the country such as the real gross domestic product (GDP) growth, the Compound annual growth rate (CAGR), the inflation rate, the unemployment rate, etc. Regarding the macroeconomics factors, a specific analysis will be faced in the next paragraph including the investment and disinvestment (exit) process.

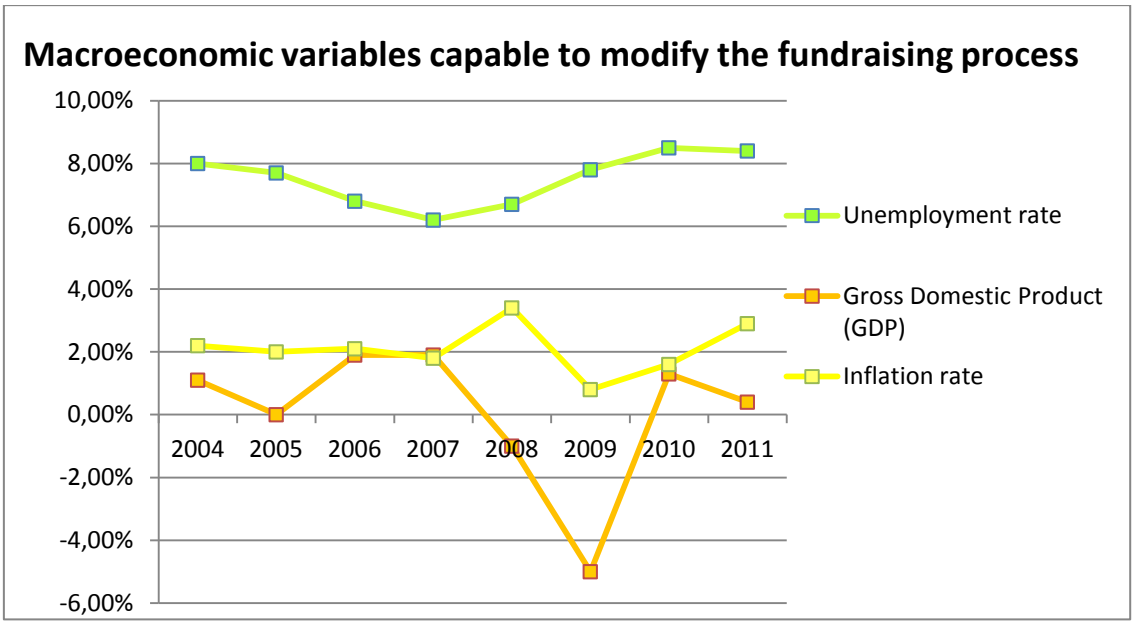

Figure 8: Macroeconomic variables capable to modify the fundraising process between 2004 and 2011
Source: AIFI Database, Bank of Italy, ISTAT

These data, collected in the graph, have to be compared with the amount of money raised every year to figure it out how every single variable is linked each other. More in detail, an increase of fundraising [Figure 8] is related with a decreasing of the unemployment rate and a growth of the gross domestic product. In fact, in 2004 the amount of money raised by the private equity market was of 1663 million (all the amount of money is expressed in €), 1% GDP growth and 8% unemployment rate compared with 1345 million raised in the following year, 0% GDP and low decreasing of unemployment

rate at 7,7%. In 2006 the funds made a giant leap to 2275 million (+69% compared with the previous year), accompanied by 1,9% GDP and 6,8% unemployment rate. In 2007, the fundraising reached the pick with 3028 million (+33% in confront of the 2006), 1,9% GDP and only 6,2% unemployment rate. In the biennium 2008-2009 the fundraising sharply decreased to 2267 (-25%) and 957 million (-58% from the previous year) as well as the GDP (-1% and even 5% in 2009) and the employment rate increases dramatically from 6,7% to 7,8%. Finally, in 2010 the Italian fundraising record a contrasting trend revealing some signs of recovery: the amount of funds raised reach 2187 million with a GDP of 1,3% even if, for the first time, the unemployment rate register a pick of 8,5%. For the last year take under analysis the fundraising comes only just over a million (1049 million) as a result of a stable unemployment rate and a slight sign of worsening (0,4%) of the Gross Domestic Product.

The main variable capable to visible modify the fundraising process is the Gross Domestic Product: every single year the GDP record a positive trend, the fundraising increases and vice versa. Otherwise, the unemployment rate is almost capable to ensue the fundraising trend even if there are some exceptions such as in the 2005 (the fundraising decreased and the unemployment rate too), and in the last biennium too: the first year recorded an increasing of fundraising like the unemployment rate and in the latter year of analysis the trend has been inverted.

A specific analysis is undertaken for the inflation rate that seems more attractive for the fundraising process when is kept between a range of 1,5% and 2% in line with the economic policy of the European Central Bank (ECB) which states the inflation should be under control in order to guarantee the sustainable growth path as well as the stability of the whole European Union, seen as a unique economic entity. As proof of what is upon written, the fundraising process report the highest amount of money in 2006 with 2275 million raised (2,1% inflation rate) and in 2007 with 3028 million raised as a result of 1,8% inflation rate.

Besides, the amount of money raised by the different types of funds are strictly linked with the geographical evolution of the fundraising: the most prosperous years in terms of money raised record a solid presence of international investors as demonstrated in

2006 and 2007 with respectively 50% and 57% of the total amount collected, in the other side the worst years experienced by the private equity market is characterized by a lesser presence of foreign investors as it shown in 2005 with the 39%, the 2008 with sorely the 18% followed by the 2009 and 2011 with respectively the 32% and 21%. The only exception is represented by the 2010 where the fundraising reached even 2187 million notwithstanding the overseas capital covered just the 2%.

2.6.2 Environmental factors capable to modify the fundraising process

The environmental factors capable to affect the fundraising process and even strictly influence the investment and disinvestment (exit) process are distinguished in endogenous and exogenous variables. According to Daniel Little essay, the endogenous variable refers to a factor in a casual model or casual system whose value is determined by the states of other variables in the system, in contrast with the exogenous variable where the factor's value, in a causal model or casual system, is independent from the states of other variables in the system under study.

2.6.2.1 Endogenous factors

The most relevant endogenous variables are the set of laws regulations that came into force between the 1999 to 2004. During this span of time the most practiced form of private equity transactions, known as leveraged buyout (it covers about the 60%-70% of all private equity deals within the Italian market), were strongly criticized from the Supreme Court or even prohibited. Notwithstanding the investors set up a multilayered buyout deal in order to elude the transaction transparency and legal dispute even if the transactions record a sharp decrease and the legal risk still persist. Without impeding the admission of the LBOs, the Italian private equity market potential might have grown faster and involve a higher number of domestic investors as well as foreign ones. As proof of this assumption, notwithstanding the Italian private equity market has been involved in several controversies regarding the legitimacy of LBOs, one of the highest net Internal Rate of

Return worldwide on a decade basis as the 31th December 2004, belong to Italy with even the 13,4% yield to maturity, then to USA with 12,5% and thereafter to Europe with 9,8% according to the preliminary data published by EVCA-Thomson Venture Economics. However, these data testify the opportunity of making interesting business for international as well as domestic funds in Italy, specially after the coming into force of the Company Law Reform that officially state the legality of LBOs as it shown in the paragraph below.

Even if the investment in Italy guarantee a significant return, one of the reasons why its market is not as developed as the Anglo-Saxon countries depends on the fulfillment of a demanding legal framework standard.

Consequently, the lack of coherent and straightforward frame of mind, regarding the LBOs admissions, limited a further international integration of the Italian private equity market in line with the most developed countries such as USA and United Kingdom losing in this way a considerable competitive advantage.

2.6.2.2 Exogenous factors

In this paragraph are listed and described the most considerable exogenous variables the Italian economy is incapable to keep under control or mitigate and must endure as the mirror, the portrait of the worldwide economy.

One of these variables is the bursting of the real estate bubble (housing bubble for residential market) began during the 2000s and peaked in February 2007. It is characterized by the sharply increasing in valuations of real property such as housing, stores, offices until they reach unsustainable levels and then decline. As of 2007, the real estate bubble involved many industrialized countries like the USA (probably where the house bubble started), Britain, Italy, Spain, France, Ireland Netherlands, Greece, Norway etc. In the end of 2010 even 11.1 million residential properties worldwide purchased through mortgages were in negative equity, which means the mortgage interests exceed the intrinsic value of their homes.

According to the Independent Real Estate Investment Financial Strategy Advisory studies, also known as CESFIM, in 2007 the Italian real estate market trend suffered the

house bubbling with an average loss of 25,6% commercial property value in the surrounding areas of the main cities toke under analysis like Milan, Turin, Naples and Rome. Consequently the domestic and international private equity funds operating in the real estate sector within the Italian market record a decline of investment which is still ongoing also due to the introduction of a national council tax named IMU (*Imposta Municipale Unica*) coming into force with the Law Decree 201/2011 experimentally applicable by 2012 and definitively from the 2015 in order to face the national expenses.

Another macroeconomic factor, strictly related with the real estate bubble, is the global financial crisis affecting the industrialized economies since the 2007 and ongoing, which plays a significant role in the failure of the key businesses and, for its momentousness, is considered to be the worst financial crisis since the Great Depression of the 1930s. In brief, the credit crunch roots are linked with the collapse of the subprime loans lending by government sponsored entities with a loss of confidence in available securitized mortgages and their ratings; suddenly the crisis crashed the worldwide financial markets and affected their related financial instruments as well as, in a second time, the real economy (decreasing of production, consumer goods consumption, spending, investments, etc.) sparing the private equity market.

In a broader exception, the latter is located in the middle between the financial market (in case the company involved is enough big for being listed through an IPO, searching capital and exiting in the stock exchange) and the real economy consequently it suffered "twice" the crisis in all its processes. A quantitative analysis, regarding the crisis effect on the investment and disinvestment processes will be taken in the following paragraph.

A further factor is the continuous growth of the emerging economies summarized in acronyms like BRIC (for Brazil, Russia, India, China), TIMBI (Turkey, India, Mexico, Brazil and Indonesia) and CIVETS (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa). The market globalization, known as the process of international integration, increases the connectivity and interdependence of the world's market and businesses putting to the test the industrialized countries due to the competitive advantages gained in the last decades by the emerging markets like low labor costs and social security system,

the introduction of new technologies capable to improve the production process as well as exploit the natural resources located in their own countries, etc.

The recent global downturn sounds like a threat for the international investments in private equity within the industrialized countries, including Italy, because of the most attractive prospective to generate return are located in the countries with the highest growth rate despite of the persistent concerns around political risk and high business overestimation valuations in countries such as Russia Brazil and India. Furthermore, developed countries have been influenced by the lack of debt financing available to complete takeovers as well as near-zero growth or even recession in USA and Europe (Greece, Ireland, Portugal, Spain) including Italy.

Thanks to the steady increase in consumer spending by investors located in emerging markets, the European and USA buyout groups are raising the needed amount of money to undertake certain type of investments even if this trend will last until the emerging markets acquire the professional knowledge on how the private equity processes work to make business by themselves.

Regarding the Italian funds is worth to underline the investment evolution: initially the latter were almost involved in seeking business opportunities in order to acquire foreign companies and expand their market share abroad; nowadays the trend has been inverted due to the blend of the macroeconomic factors previously mentioned.

2.7 The investment process in Italy

Investing is the core of private equity business and also the pathway to develop a business idea for the investors. Selecting investment is a daunting task, because there is information asymmetry based on the interaction between impartial components, analyzed through methodological rigor, and subjective experience like intuition, flair and entrepreneurial spirit. This screening is strongly influenced by the typology of investment and the strategic orientation carry on by the investors regarding the will of purchasing the

majority stake or minority stake in order to list in a short term the target company as well as identify the geographic location, the sector and the type of product to invest in.

However, is possible to generally illustrate the typical phases, adopted by the most profitable funds in terms of IRR, involving the investment process in the following way [Figure 9]:

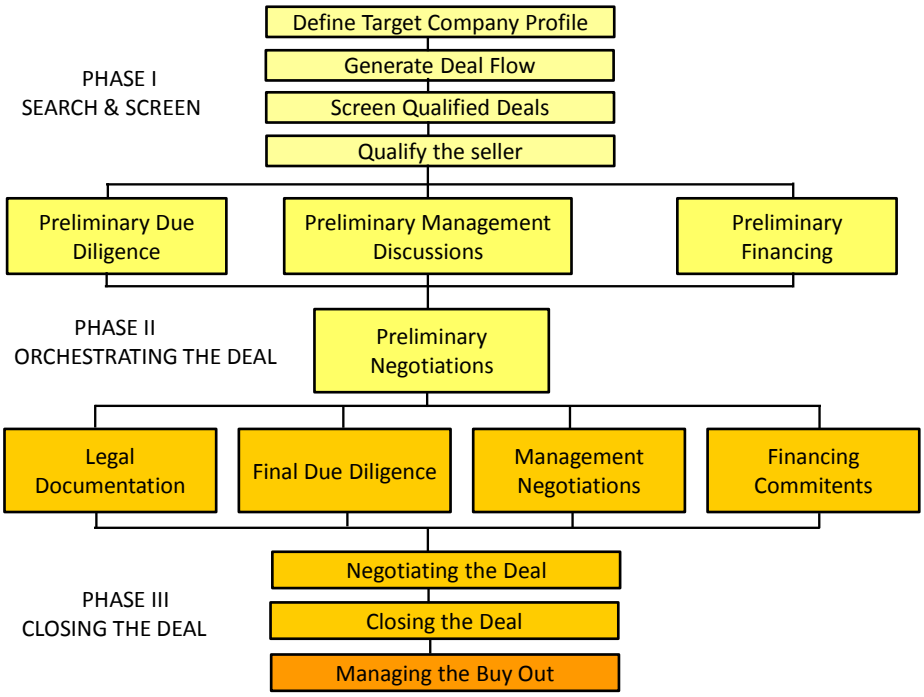

Figure 9: Typical investment process phases within leveraged buy-out operations
Source: J Terrance Greve, Business Publications San Diego, California 1987

- Identify the target company: seeking the investment opportunities is the main task during the pre-investment phase where a series of critical factors are defined to figure it out whether they affect the investor's choice about the capability to generate the desired deal flow.
- Evaluate the entrepreneurial profile and/or the management team: once the investment opportunities are identified, is appropriate to make sure the management team

is reliable, competent, experienced (track record), renowned in order to undertake the investment with a lesser risk.

- Evaluate the company profile and the operation structure: orchestrating the deal to assess the viability of a potential investment and the accuracy of the information provided by the target company through a preliminary due diligence regarding the management and financial aspects.
- Negotiation and pricing: usually this phase is the natural prosecution of the previously steps. The aspects of negotiation to take under consideration do not concern only the price but also the payment modalities (increase capital, share premium account, right of pre-emption).

In Italy, the Search & Screen phase represent one of the most arduous task to determine due to the underdeveloped financial market compared with the United Kingdom and USA reality. Actually, the latter are characterized by an active presence of investors involved in scout around the financial partner differently from Italy where the lack of knowledge of such activity makes necessary a "direct marketing" promotion by private equity operators with a considerable waste of resources for seeking business opportunities.

Another important difference existing between the Italian and the Anglo-Saxon buyout investments consists on hiring a professional team with extended experience in merger and acquisitions (M&A). Italy is used to get in touch with professionals only for relevant dimension transactions like large-mage deals, which are year by year slowly decreasing (52% in 2008, 50% in 2009, 46% in 2010, 41% in 2011), because the almost involve small-medium enterprises where the support is given just by a chartered accountant or a trusted advisor taking care of all the tax, legal, financial aspects. Obviously, this is a point of weakness for the whole investment carry on by a unique specialist because a professional team, made of several experts, might cover deeply every single subject even if is strongly suggested to evaluate in advance the economic convenience of recruiting them.

According with the data collected by the Italian venture capital association, is worthy underline the private equity investments are almost geographical attracted in the North of Italy (mainly in Lombardia area) with the major target firms operating in industrial and

basic material sector (56%), services/financial services (17%), consumer goods (16%), healthcare (5%), technology (3%).

In particular, the North of Italy cover a range of 70%-85% of the whole private equity investments, the Center of Italy around the 15%-25% and finally the South of Italy with only the 2%-3% of the investments in term of amount of money and more or less the same numbers of deals. These data, at a first sight, might explain the investments are often concentrated in certain regions of the country because new technologies are developed and improved in technology clusters.

Moreover, explicitly for the venture capital firms, the investment location is identified close to these clusters, or in proximity of university-based research, in order to monitoring and screening every single step of activity. As proof of this line of thought, a consistent number of deals, highlighted in [Figure 10], are registered in the regions with the highest pro capite GDP such as Lombardy, Emilia Romagna, Friuli V.G., Veneto, Piemonte, Lazio, Toscana.

REGIONS	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	TOTAL
Lombardia	79	74	76	55	83	96	81	105	86	89	80	904
Emilia Romagna	36	41	48	15	37	27	38	46	21	29	34	372
Friuli V.G.	30	34	51	33	21	31	25	27	26	44	32	354
Veneto	16	11	22	13	26	19	22	29	16	19	34	227
Piemonte	16	14	22	27	11	22	18	26	21	17	24	218
Lazio	12	16	14	12	13	18	27	26	23	29	16	206
Toscana	20	12	9	11	18	17	14	23	14	12	25	175
Umbria	3	1	4	1	1	0	9	29	20	5	3	73
Liguria	4	3	14	5	1	4	3	5	8	9	8	60
Marche	9	3	5	3	6	7	4	5	6	6	5	59
Sardegna	5	4	4	3	5	2	8	5	3	12	8	54

Campania	5	0	3	6	3	8	7	1	3	7	11	49
Trentino A.A.	3	2	4	5	2	11	6	5	8	0	4	47
Abruzzo	4	2	4	6	3	0	3	2	0	2	5	27
Puglia	4	0	0	1	0	2	0	3	2	1	7	16
Sicilia	3	0	0	0	0	0	1	3	2	3	6	15
Calabria	7	0	0	0	1	1	1	0	2	0	1	13
Basilicata	1	1	1	1	1	0	0	0	0	0	0	4
Molise	1	0	0	0	0	0	1	0	0	0	1	2

Figure 10: Private equity deals the decade 2001-2011 divided per Italian regions
Source: AIFI Database , PRICEWATERHOUSECOOPERS, ERNST&YOUNG

However, there are some exceptions: the Umbria region, in despite of its medium economical condition, in 2008 register even 29 deals in confront of an average of less than 10 deals in the previous years, the Trentino Alto Adige region also associated as one of the most prosperous Italian region attest only a range of 4-6 deals per year.

2.8 The investor's behavior in the past decade

The analysis below is focused on the Italian private equity deals occurred in the past decade, in particular dividing the span of time taken under consideration in two period in line with the macroeconomic scenario: the first period between 1999 and 2006 when the almost law reforms toke place in order to regulate the LBOs transactions, and the second one between 2007 and 2011 characterized by the collapse of the developed economies.

The data collected in this paragraph are obtained through a survey forwarded by Simona Zambelli (Professor at Forlì School of Business) on December 2005 and filled out by all members of the Italian Venture Capital association, also known as AIFI, and to the mainly partners of every single private equity firm operating actively in the Italian market.

Thanks to this collaboration, it is possible to provide a truly overview of each deal (Figure 8) occurred in this country: 27 private equity funds acquired 162 firms. Among the private equity funds, 12 (44%) are managed by Italian independent closed-end funds, 8 (30%) are International independent limited partners, 4 (15%) are Italian bank subsidiaries and 3 (11%) are International bank subsidiaries. Among the target firms, 103 firms (64%) are acquired through LBOs, 47 firms (29%) and 12 (7%) are relatively acquired through the expansion and replacement. The distribution of the transactions by type of investors mainly attract independent investors on the buyout sector, while bank subsidiaries are generally focused on expansion and replacement deals because is associated a lower level of risk. During the period in which the legitimacy of these deals where uncertain or even prohibited the number of buyouts was instead relatively low compared with the introduction of the New Corporate Reform increased dramatically (from 13 to 26 transactions respectively in 2003 and 2005). Furthermore, these transactions are characterized by an average of two co-investor, one financing round completed by the fund, a 31.000.000€ average of the target firm's value, a multiple used to evaluate the company of 5.4 calculated with the Enterprise Value/EBITDA ratio, a 37% equity stake held by the lead private equity investor, a 58% equity stake held by all the private equity investor and an average of 2,5 years of involvement in the target firm.

Regarding the investment distribution, the target companies involved in these transactions are divided into low tech and high tech sectors. The low tech include in descending order the following areas of belonging: industry goods, manufactured goods, consumer goods, financial services, real estates, etc. Due to the considerable risk discounted by the high tech industry, these sector is ever composed of brand news even if the upper hand is neatly driven by internet (notwithstanding the dot.com bubble burst, it is the driving force within the high tech sector), telecommunications, biotechnology, electronics, etc.

The second period is almost influenced by the global recession affecting the whole developed economies which mainly modify the private equity investments in terms of amount invested, the deal structure, the sectors involved, etc. The transactions by type of investors still attract independent operators interested in buyout deals compared to banks,

on the one hand, unable to own an adequate organizational structure to take operative risks linked with the more risky operations, on the other hand, in an attempt to improve their critical economic and financial position try to avoid any kind of risk related in private equity investments and even do not grant loans for enterprises without adequate guarantees. These policies are the result of a liquidity crisis that puts a strain up to the extreme the banking and insurance system like the biggest worldwide bailouts regarding institutions such as Northern Rock, AIG Inc., Fannie Mae, Freddie Mac or even to the failure of Lehman Brothers, Washington Mutual Inc., etc.

Not immune from this contagion is the Italian banking system, incapable to face the credit crunch notwithstanding the recapitalizations of several banks institutions including the Italian leading bank, Unicredit Group S.p.A. Due to the decreasing number of loans issued by the bank system and the rising in official interest rates (except for companies providing enough guarantees), the small medium enterprises come into a vicious circle because of the lack of funding for undertaking their businesses recorded a sharp dropdown of cash flows generated, difficulties in paying employees on time besides collecting accounts receivables, delay in payments, etc.

Demonstrating how the global crisis has affected the whole economy, the leading sector involved in the transactions still comprehend almost the same areas of businesses but record an unprecedented heavy losses: the manufactured goods (-25%), the consumer goods (-22%), the real estates (-16%).

As proof of the critical conditions, is widespread the failure of many enterprises as it shown from the data collected by Unioncamere-Infocamere: in 2007 the companies declaring bankruptcy are 7755, in 2008 are 9063, in 2009 even 11477 and only in the quarter of the last year took under analysis are 9370, recording an increasing of the 19,5% compared with the same span of time of the previous year. Other important data testifying the arduous economical situation the company have to face are collected and elaborated by the Turnaround monitor - TaM®. This survey include a sample of 6704 companies with a revenues range of 20 to 200 million Euro, identifying a company potential distressed with a Debts/EBITDA>5 ratio, Debts/Equity>3 ratio and a coverage of interest expense lower

than one. Even 2705 firms (around the 40%) under analysis are in a potential situation of financial distressed and as time goes by such trend is becoming more are more tangible.

To stem the spreading crisis has been reformed the Italian Bankruptcy Law through the introduction of the Legislative Decree No. 169/2007 coming into force from January 1st 2008, substituting the Royal Decree No. 267/1942. In brief, through the Reform lawmakers sought to introduce more efficient and transparent regulations of pre-bankruptcy procedures and debt restructuring agreements. One of the principal aim of the Reform is to give support and facilitate the turnaround of companies through three interventions according with the seriousness of the situation: restructuring the Debt Positions (art 67), negotiation of the Debt Restructuring Agreement (art 182bis), provide consensual pre-bankruptcy solutions (also known as *concordato preventivo*, art 160) for companies facing the financial crisis, in order to reduce the expensive social costs associated with value destruction and reduce the risks arising out of private arrangements with creditors.

Therefore, to prevent a disastrous economic scenario within the Italian economy is taking more and more shape the turnaround strategy for managing, stabilize, fix distressed and underperforming companies into successful ones thanks to the more flexible set of rules introduced with the Bankruptcy Law Reform.

2.8.1 Turnaround: how to relaunch underperforming companies

In such critical economic context within the Italian market, a wide importance is given to the private equity fund's capability to continue and maintain, over time, the target companies value through complicated turnaround financing operations. Differently from the main other financial institutions such as banks, wealthy individuals, pension funds, etc., capable to grant sorely the risk capital to undertake the company's restructuring, the private equity operators also provide several advantages, as a result of the extensive experience gained in this sector. Just to name a few, the management know how as well as the consulting and strategic services are the main elements of strength to relaunch the target company, decreasing the risk related with a potential failure (write-off).

In Italy, the turnaround operations remained at low and stable level until 2005 due to the regulatory uncertainty and for the high risk associated with this type of interventions; indeed the latter were not as needed as nowadays due to flourishing economic situation that characterized the early 2000s. However, in the biennium 2006-2007 there has been a significant increase in the amount of funds invested passing by 28 million Euro in 2005 to even 145 million in the last year, thanks to the implementation of some operations in size dimension. Other reassuring signals concerning the claiming of the turnaround financing are coming from the first half of the 2009: the resources invested are more than tripled over the same period time of the previous year (passing from 22 to 78 million Euro) covering even the 8% of the whole types of investments in private equity notwithstanding these ones recorded a fall of the 61% in the amount invested.

The most interesting aspect that deserve to dwell regard how the common opinion perceive the private equity as one of the contributing factors to the current financial crisis and the growing depression in the global economy but in this paragraph, and also in the whole essay, is underlined that such investments, specially including the turnaround operations, are almost seen as a positive change agent capable to make profitable underperforming companies as well as conducting company bailouts that otherwise would have failed. As proof of what is affirmed, larger companies begin to understand the importance of relying on experienced operators in order to solve their company's distress that could even lead them to bankruptcy with a disastrous effect for the domestic economy in terms of gross domestic product, stock market values, layoffs as well as fueling a vicious circle that puts a strain on all the companies who are dealing with, such as suppliers, chartered accountants, etc.

2.9 The disinvestment process in Italy

The disinvestment and subsequent exit phase of the financial institution from a company is the last phase of the private equity cycle as well as the most important because from the quality of the work done in this step by the private equity operators depends the successful of the whole investment in terms of profit generated, usually measured through the Internal Rate of Return (IRR). This phase is generally divided in two aspects: identification of the channel to be used and choose the appropriate time for disinvest.

Due to the relevant role played by the disinvestment process, many studies and element of research has been spent regarding this subject briefly illustrated in this paragraph. However, there are two contrast opinions about the strategic topics capable to provide a value-added in such operations: according to Schweinbacher the main issues to consider are the investment length, the external economic environment, the sector, the stage of development, and according to Cumming are fundamental the individual agreements, the governance, the dividend policy, the existing financial leverage. The individual agreements, signed by the private equity operators and financial institutions, is referred as an incentive for including in the contract clauses that give them the opportunity to disinvest when the time for exit is closed.

Although the private equity operators are involved in different stage of the target company lifecycle, the typical exiting strategies used by the Italian market are the following: trade sale (sale its stake to a corporation or an industrial shareholder), buy back (sale its stake to existing shareholders in the corporation or their representatives), sale to other private equity investors, write-off (partially or totally devaluation due to a failure investment), IPO or sale post IPO. This latter is the most profitable and also considered the best solution for developing a solid reputation for potential future deals but is quite difficult to occur due to the considerable amount of money required to list the company in a stock exchange.

Even though the Italian economical context is plenty of family-owned company comprehending the 90% of the entire domestic companies with an impact on the Gross Domestic Product (GDP) of the 80%, exist some issues obstructing the business

developing where the toughest challenge they face is the succession planning. Sorely the 24% of the Italian companies survive from the first to second generational planning and even 14% at the third one because of unresolved issues including leaving the business to the surviving spouse, treating children equitability, planning in a vacuum, technical mistakes, etc. As it shown from the data collected by AIFI and Pricewaterhousecoopers, nowadays the IPO cover just the 5-10% of the whole deals taking place in the Italian market recorsing slight decreasing over years.

Among the different exit types, the most remarkable data reflecting the domestic economical trend is the considerable number of write-off carry out by the private equity houses due to the high uncertain situation and economic contingencies. In fact, the company reduction in recognized value appear more and more concrete since the beginning of the economical crisis: till the 2006, write off covered an average of 3-5% of the total investments amount compared to 15% recorded in the span of time between 2007 and 2011.

In conclusion, analyze the Gross Pooled IRR on realized investments (strictly connected with the write off exit) provides a wider insight of the market and global economy trend, even though it might be affected by some borderline cases within the common practice among of private equity deals.

	2011	2010	2009	2008	2007	2006	2005
N.of realized investments from inception	85	52	42	78	99	88	71
Yearly Pooled IRR	12,6%	-11,4%	-16,6%	18,9%	29,2%	28,5%	25,1%

Figure 11: IRR from inception by year in 2005-2011
Source: Re-elaboration of data collected within AIFI Database

It is worth to note in 2009 the Pooled IRR plunged to -16,6% [Figure 11], showing for the first time an overall negative performance since the beginning of the analysis because of the significantly number of relevant write off. More specifically, the overall

number of write off increased to 17 from 14 in 2008: the incidence by number more than doubled (40% in 2009 and 18% in the previous year). In 2010 the write off had a lower impact on the whole investments even if the yearly pooled IRR still remained negative due to the poor performances. Gross pooled IRR on Realized Investments from inception showed a significant upturn in 2011, coming back to a positive performance of 12,6% after an underperforming biennium. The latter year under analysis reflects the overall positive returns of the disinvestments made during the year, thanks to several factors like over performing transactions involving large companies, relevant decrease of write off in terms of Cash Out and a considerable number of realized investments (85 deals compared with 52 in the previous year) definitely bring confidence in a future recovery.

2.10 Successful Italian private equity investments divided by typology

In this paragraph are listed and described successful business cases of private equity deals occurred in Italy in the 2000s in order to provide a general overview of how the actors involved in such operations define the appropriate strategies to improve the target performances through specific interventions. Make a successful deal is a complex business because is necessary to figure out the intrinsic competitive advantages that are not yet exploited within the target company as well as succeed to control and manage the dynamic risks, continuously expressed in different facets, as a result of the market globalization.

Regarding the typology of companies involved, is worth to underline in the early and expansion stages the main activities are focused on biotechnology, pharmaceutical, high technologies sector compared to buyout and turnaround stages where the company's core business is based on manufacturing, consumer goods, real estates, etc.

The analysis is based on data collected from different sources like the AIFI Database, the private equity operators website carrying out these transactions, the Italian business newspapers *Il Sole 24 ore* and *Milano Finanza*, the magazine *Economia e Management* edited by the Italian business school SDA Bocconi.

2.10.1 Early Stage

- **BIOXELL**

Company profile

Bioxell was founded in Milan on January 2002 as a spin-off from Roche, a diagnostic division of Hoffman-La Roche which manufacturers equipment and reagents for research and medicinal diagnostic applications. The company is an innovative biotech company, leading research and drugs development for the treatment of inflammatory and urological diseases. In particular the company is a pioneer in chemistry as well as in developing Vitamin D3, through which is studying a key drug, the Elocalcitol. Moreover, Bioxell can claim important licensing agreements with companies leaders in the pharmaceutical industry.

Investment process

The investment has been taken by Finlombarda Gestioni S.p.A., through the fund NEXT which is promoter and manager, in early 2006 in a round of funding of 10,5 million Euro led by German TVM Capital and also involve some of the existing investors, BB Biotech, Index Ventures and Life Sciences Partners. Over the years subsequent of its foundation, Bioxell had already been subjected of investment by international venture capital funds specialized in deals around 100 millon Euro.

Disinvestment process

A few months after the investment, Bioxell aimed to be admitted to the Zurich stock exchange, a renowned market for its specialization in pricing biotech companies. The trading of securities started on June 22, 2006 and at the end of the year the shares were appreciated by about the 20%.

Private equity operator

Finlombarda Gestioni SGR S.p.A. is a company owned by the Lombardy Region financial asset management department, the Milan Chamber of Commerce and the Politecnico Consortium for Innovation. It manages the Fund NEXT, active since the end of 2004 with a total commitment of 37 million Euro, the first venture capital closed-end fund made of public-private partnerships in Italy. NEXT was created by the Lombardy Region in order to develop a venture capital market oriented on innovation and development of new technologies. Finlombarda Gestioni SGR S.p.A also manages EUROMED, a private equity fund with a budget of 50 million Euro.

- **EUROTECH S.p.A.**

Company profile

Eurotech Group was founded in 1994 and operates in the research, development, production and marketing of laptop and computers with high calculation speed. It is currently active in several European countries, USA and China with research and production facilities as well as commercial offices. Eurotech Group is the European leader of super computers and among the top 10 manufacturers worldwide of laptop with a turnover around 65 million Euro.

Investment process

Friulia participated in the target company growth through two financial rounds of funding since the start-up phase. In 2001, in partnership with the Private equity First GEN-E fund, undertook a new investment for sustaining the company development for internal and external lines. In November 2005, Eurotech Group was successfully listed on Milan Stock Exchange (incorporated within the London Stock Exchange) in the MTAX index while the fund GEN-E disinvested its stake. Thanks to this operation, Friulia acquired the anglo-american ARCOM (almost the same size of Eurotech group) doubling in this way its

market share. In the summer 2006, Friulia launched a second share capital increase fully subscribed by the financial market with the aim to support further acquisitions.

Disinvestment

Friulia disinvested its participation just after listing a small stake for covering the high demand of the title. The present value of listing, in case of disinvestment at the end of the lock-up period, the Internal Rate of Return (IRR) of the transaction would exceed the 60%.

Private equity operator

Friulia is a company owned by the Friuli-Venezia-Giulia Region financial asset management department, contributing to the creation and development network for companies through participating, funding, advising and providing them technical assistance. These interventions are focused on supporting companies located within the Friuli-Venezia-Giulia Region during the Early Stage and Expansion coming to affect up to 35% of the share capital with a time horizon between four and six years.

2.10.2 Expansion

- **B-PACK DUE S.p.A.**

Company profile

B-PACK DUE operates in the production and marketing of high quality polypropylene film, made through the cast technology, for food, pet-food, manufacturer and medical industries. The company was founded in 1996 and in a few years enjoyed a significant and steady growth becoming the sector leader within the Italian market and one of the major players in Europe thanks to a technology and quality leadership.

Investment process

In 2006 the investment process was carried out by 21 Investimenti fund in order to implement the preexisting expansion plan focused on exploiting the company technology in the pet-food and medical sterilization. Thanks to this successful plan, nowadays B-Pack Due strongly hold a leadership position throughout Europe and improving an internationalization process through partnerships with major customers as well as consumers.

During the last four year of investment the company's revenues grew by 50% and profitability has doubled.

Disinvestment process

In September 2010, 21 Investimenti sale its 100% stake in B-Pack Due to the world's largest packaging company: the Australian Amcor Ltd. Before being sold, In September 2009, the revenues were around 43 million Euro with an Ebitda of 8,8 million Euro.

Through the income corresponded by such investment, the private equity fund realized a return greater than 2,5 (250% in terms of Internal Rate of Return) times the capital invested.

Private equity operator

21 Investimenti is the investment fund of 21 Italian Partners, the international business and finance group ideated by Alessandro Benetton, which invests in middle size companies (50 to 500 million Euro) in order to support them in developing their potentials. The group is made of 30 investment professionals lead by 8 managing partners, working between Italy and France with a 1,5 billion Euro current value of assets.

- **Fila S.p.A**

Company profile

Fila S.p.A. is one of the major worldwide companies producing stationery and school items, thanks to the acquisitions of European brands like Tratto, Giotto, Pongo, Das, Lyra and USA and Central America brands: Ticonderoga, Dixon, Prang, Vinci. Through the acquisition of Dixon, Ticonderoga (2005) and Lyra (2008), Fila became the biggest multinational producing pencils for writing and drawing, with important industrial productions located in Italy, France, Germany, Mexico, China.

Investment process

In 1999 the Merchant Banking Department of Intesa San Paolo, through a capital increase, joined the company with a minority stake in order to implement the strategic plan. In this way, Fila has pursued a path of growth that enabled it to take a giant leap in size and reach the current position in the international market position.

Disinvestment process

In November 2010, Intesa San Paolo sold the 50% of its stake (equivalent to the 12,4% of the share capital of the Fila Group) to the private equity fund Edmond de Rothschild Investment Partners, specialized in development capital operations. The main goal was to broaden the shareholder base of the group to an international operator of high standing able to support the company, together with Intesa San Paolo, in a path of consolidation and further expansion process in view to a potential listing in a stock exchange over a span of time of three/four years.

The private equity operator

The Merchant Banking Department of Intesa San Paolo is the structure set up for the recruitment and management of equity investments within industrial and services sectors. The activity is carried out directly through its subsidiary IMI Investimenti and some funds of the Group specialized in small-medium companies as well as venture capital

investments. The management team comprehend 19 professionals and 23 employees focused on the funds of the Group, while the total portfolio amounted to about 2,8 billion Euro.

2.10.3 Buyout

- **AZIMUT HOLDING**

Company profile

Azimut Group is specialized in the promotion, management and distribution of financial products and services. In a decade the company becomes one of the Italian leading asset management entity thanks to the financial advisors hired, the originality of the business model for innovation adopted as well as its independency from any banking, insurance and industrial group. In 2004, Azimut were composed of 880 promoters capable to guarantee a turnover greater than 150 million Euro, managing over 8 billion Euro portfolio on behalf of more than 100.000 customers.

Investment process

In February 2002, Apax acquired Azimut Holding during the difficult economical situation following the September 11, 2001. The successful key of this operation is the result of a cohesive management team able to make risky choices in a really difficult market environment. Thanks to this private equity operator, the target company has greatly increased the rate of revenues growth and has maintained high profit margins by implementing a process of strengthening the distribution through the acquisition of six regional SIM (*Società di intermediazione immobiliare*). The main investment decisions regard the management support in refinancing its debt: in this way has been recorded a considerable growth in the number of employees, including external managers, and the introduction of stock options bonus for financial advisors capable to improve the company's performances.

Disinvestment process

In July 2004, Apax sold its major stake through listing the target company on the Milan stock exchange (incorporated in the London Stock Exchange), creating thus one of the few public companies operating in the financial services within the Italian market. The disinvestment contribute to create a strong management, transparency and credibility towards the investors.

Private equity operator

Apax Partners is one of the seventh largest private equity and venture capital globally firm, headquartered in London with offices located in the main worldwide financial centers. The funds managed by Apax Partners pursues a balanced portfolio strategy, investing in companies with strong growth potential (the common sleeping beauties) in the whole levels of development, from starts-up to buyouts. Moreover, Apax currently manages 12 billion Euro worldwide (raised approximately 35 billion Dollars dating back to 1969, when it was founded) with a team made of 160 professionals.

- **POMPE GABBIONETA S.p.A**

Company profile

Pompe Gabbioneta S.p.A. was founded in 1997 in Sesto San Giovanni, Milan. The company is a leading manufacturer and distributor of centrifugal pumps for the oil sector, operating in the major international Oil & Gas markets.

Investment process

The acquisition occurred in 1999 as a result of direct contacts between the family Gabbionetta and the private equity operator Aksia Group in order to change in a long-term prospective the managerial organization from a typical "family" control to an international team capable to expand its business abroad. A particular attention was given in R&D

research as well as seeking a more efficient structure for sale the target company products and order management.

During the investment period the company has doubled its production capacity and testing while the employees increased from 150 to 240. The turnover passed from 30 to 50 million Dollars, hand in hand with the gross margin growth which reached 10,8 million Euro at the time of disinvestment compared to 7 million Euro in 1999.

Disinvestment process

The disinvestment took place in 2005 when Aksia fund sold the target company to the Scottish industrial group named Weir Plc. Following a valuation of 100 million Euro, 11,4 more the Ebitda recorded the previous year with an overall return for the investor equal to 6 times the initial investment with an Internal Rate of Return of 39%.

Private equity operator

The private equity operator Aksia Group, through its fund endowed of a 65 million Euro budget, is mainly focused on acquiring controlling stakes in industrial companies located in Italy. The business strategy is usually on a scale-up basis, with the aim of implement the dimension size and the management quality. The main investors of Aksia Group are Banca Intesa Group, State Street, Merifin Capital and HDI Assicurazioni.

2.10.4 Turnaround

- **CIRIO DE RICA S.p.A.**

Company profile

Cirio De Rica S.p.A., founded in Turin in 1856 as the subsidiary of Conserve Italia Group, operates in the vegetables canned food and in particular produce tomato sauces. Nowadays is one of the major player in this sector owing its success to the product quality,

technology innovation and marketing strategies pursued since the beginning of the previous century anticipating the modern approaches to active involve the consumers.

Investment process

This operation is one of the main critical Italian turnaround investment carried out by private equity and venture capital funds due to the temporary receivership affected Conserve Italia Group, in order to bailout the subsidiary Cirio De Rica.

Monte Paschi di Siena Venture department, along San Paolo IMI SGR and Banca di Credito Cooperativo SGR, signed an agreement to acquire the target company through a competitive bidding procedure. This cluster of investors implemented the company's market share, in particular paying attention to the marketing strategies and thanks to the operative and financial synergies which have arisen between the two parts following the investment. Besides saving the target company from an almost certain bankruptcy, the new shareholders maintained the level of employment. The acquisition amounted to 82,7 million Euro involving the entire capital, with a Debt/Equity ratio of 1,50 (the equity component was equal to 55 million Euro).

Disinvestment process

During the 2006, the exit way of the private equity operators came through the disinvestment of their stakes to Monte Paschi di Siena Venture department, the industrial partner who had participated in the operation with a major stake of around the 51%. Furthermore the Internal Rate of Return reached the 8,5% of the total deal.

Private equity operator

Monte Paschi di Siena Venture department manages seven mutual closed-end funds throughout Italy, for a total amount of approximately 400 million Euro. The operator's objective consist in financing medium-sized companies operating in manufacturer, commerce and services sectors. Since its foundation, MPS has already made 28 investments, 13 of which through the disinvestment.

- **FAVINI S.r.l.**

Company profile

Favini S.r.l. produces highly specialized manufacturing paper using the waste materials, including rags and algae which are dried and then ground in a special mill before being added to paper. Today the company is divided in three divisions: graphic specialties, converting products and release papers. In a mature sector such as papermaking, Favini has positioned itself at the top of the pyramid with high value added products coming from a considerable quality service, production flexibility, product innovation and geographical diversification.

Investment process

In 2008 the investment was carried out by Orlando fund through a closure agreement of creditors (also known as *Concordato preventivo in Italian language*) due to an unprecedented crisis the company has never faced before. The investor strategy was based on three pathways: re-focus the activities around the two Italian mills, close the Dutch mills quickly and efficiently, reducing dramatically the debt and implement the production of high value added goods. Therefore, once such strategy took place, the main financial indicators began to grow again.

Disinvestment process

In February 2011 the target company has been subjected of a Leverage Buyout, which allow the exit of the old shareholders generating a profit of 2,5 times the initial investment. The previous management was replaced by different kind of investors such as Credit Agricole private equity, Mare Holding and Orlando itself, which have reinvested the upside in the new development strategy.

Private equity operator

Orlando Italy management SA is an independent private equity firm supporting national and international institutions experiencing management problems, earnings

shortfalls, high debt levels, difficult succession problems in order to make them profitable in a medium-long term. The fund is managed by a team of financial professionals with a background in solving complex economical situations through its 200 million Euro budget to invest in the Italian market.

3 PRIVATE EQUITY IN CHINA

3.1 Introduction

The aim of the present chapter is to provide deeper insights and better understanding of the Chinese private equity industry. Even though it's history is relatively young, only about twenty years, the economic growth is still dramatically accelerating becoming in this way the second-largest economy in the world. Due to a conjuncture of several key dynamics never experience before in the nation's history, China attract numerous international investors worldwide wishing to make business in this territory where enormous potential, as well as challenging, are still hidden.

Differently from the past, the Chinese policies are definitely supporting a liberalism economy-oriented as a result of the globalization process where the private equity investments play a fundamental role in order to integrate the domestic market with the foreign ones conversely to what is happening in the developed economies. In fact, seems the economic role has been inverted especially for what concern the private equity market: the latter are considered as a value-adding technique and a value-added resource in China, differently from the nowadays line of thought widespread in developed countries (including Italy) where such operators are strongly criticized and retained guilty as one of the main causes for the global financial crisis outbreak.

Notwithstanding the Chinese economy privatization is one of the main goals for the domestic market, the State control the main strategic sectors like banking, telecommunication, oil and gas, energy, automotive, etc. Although the international investors are useful for transferring management know-how to their portfolio businesses, build globally competitive companies, create a solid network of contacts, the Chinese policy present some traces of protectionism. Rising funds in Yuan-denominate funds, favorable treatment reserved to domestic funds regarding the wider range of investment opportunities are the main reasons.

In the last section are reported significant data regarding the positive social and economic impact of equity investments carried out by private equity backed firms

compared with publicly listed firms. Moreover, private equity houses play a fundamental role in contributing to China's long-term economic and development goals through improved job opportunities and innovation, increased R&D investments, paying attention on corporate social responsibility, implement the "Go West" policy. On the other hand, they guarantee satisfy financial performance, provide critical support for smaller companies, improve corporate governance and spur growth, support the expansion of the China's consumer goods and retail industry.

3.2 The main reasons why investing in China

Over the thirty years, China has experienced an unprecedented economic expansion in a short historical period of time which catapulted the country into the ranks of the world's top economies powers. While most developed nations recorded a moderate growth during the last ten years, China has grown at a staggering rate, averaging more than 9% over the last 20 years, recently superseding Japan to become the second-largest economy after the U.S. thanks to the economical, financial, political system reforms, urbanization and development of education and research.

The most important peculiarity of the Chinese expansion that makes this country different from the word's developed economies consist in achieving the economic development in a context of globalization. In fact, China has integrated itself in the world economy system through gradually opening its market accepting foreign directed investments and consequently attract dozens of private equity firms seeking business opportunities all around the country.

Due to the robust economic growth, the State-owned enterprises privatization, abundant opportunities, little competition respect in the developed economies, increasing of consumer spending make China one of the most attracting countries worldwide for private equity investors. Despite the 16 billion Dollars invested in 2011, there is still a relative lack of competitiveness among private equity houses if we consider this asset class represent just the 0,2% of the Gross Domestic Product. Even though there are considerable positive signs for investing in China, managing this rapid growth is one of the key

challenges to generate profitable deals. In particular, a persistent growth trend need an appropriate monetary policy to keep under control the inflation through increasing the bank's reserve as well as the interest rates. Although risk still remains, foreign investments are driven by the conjuncture of several key dynamics never experience before in the nation's history which include the following ones:

- Favorable demographics trend: an increasing of the total working population (aged 15-64) from a 50% in the early 1990s to more than 60% nowadays, and is not expected to decrease until at least 2015;
- Consumption oriented company: China's high savings is still increasing and consumers have augmented their income consequently China's private consumption is expected to grow from a 35% of GDP till 50%-60% in the following years;
- New reforms: Chinese government's aim, through its five years plan, consist in encouraging social development and boosting demand as well as providing useful contents for private equity firms seeking investment opportunities in China;
- Rural development: rapid urbanization and government favorable policy designed to advance rural development are aimed to concentrate the investments in the inland regions. These programs is part of campaign known as "Go West": promote a fast and healthy development of the western areas in order to diminish the economical and social gap between the two areas;
- Economic stability: China's government has undertaken several fiscal and monetary policies as well as maintain a strong balance sheet. The latter has been controlled through keeping the total government debt below the 50% of its GDP, well below the ratios of many developed countries;
- Positive attitude towards foreign investments: in 2009, China attracted around 106 billion dollars of foreign direct investments coming from 450 of the world's top 500 companies;
- Dynamic capital market: in the last several years China is becoming a relevant player in global capital markets thanks to the continuous growth of the Hong Kong (if we consider this city as part of China), Shanghai and Shenzhen stock exchange.

A key example is the creation of ChiNext in 2009 in order to compete with Nasdaq, London's AIM and Hong Kong's GEM for the listings of small start-ups.

3.3 Overview of the private equity industry in China

China is considered the next frontier for private equity investments throughout Asia. During the period from 2000 to the peak of the global economic expansion in 2007, the deals grew at a compound annual growth rate reached the 45%. Notwithstanding the new investments slowly decreased in 2008 due to the financial crisis, the positive trend still continued in 2010 with a deal volume of 9 billion dollar, doubling the performance of the previous year. However, also the private equity fundraising is going hand in hand with the investments undertaken (the trend is almost the same as it underlined in the two graphs proposed in this paragraph): in the last ten years were raised more than 35 billion dollars by private equity houses targeting investments in China. More in detail, as it shown from [Figure 12], the process rose dramatically in 2005 with an extraordinary growth of 600%, jumping from just 300 million to 2,2 billion dollars.

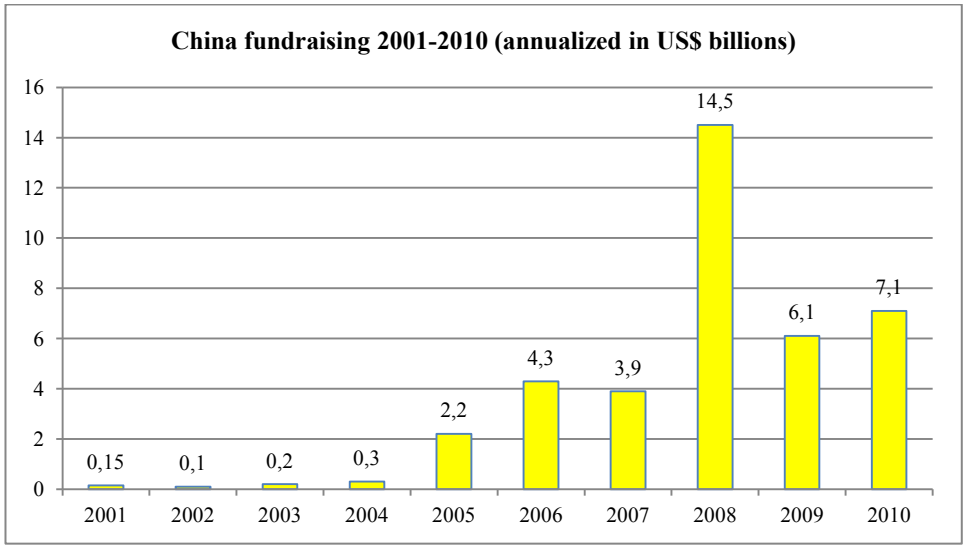

Figure 12: China fundraising 2001-2010 (annualized in US$ billions)
Source: EMPEA, excludes state-sponsored industrial funds

In 2008, fundraising hit a peak of 14,5 billion dollars and then record a decline in line with the worldwide trend even if the biggest private equity firms (Blackstone, JP Morgan, CVC Capital, The Carlyle Group, 3i, etc.) do not hesitate to invest in China like also the domestic funds founded by local bankers which attract interest among the foreign investors (Hony Capital, China Safe Investments, Daiwa Private equity, etc).

Comparing with the other countries and regions, the investment process is characterized by many factors similar to the venture capital industry due to the rapid growth of China's economy. In fact, more than 80% of the entire private equity investments are focused on providing the capital needed to finance new business and expansion companies of small and mid-sized when the entrepreneurs have limited access to bank loans. As proof of the active involvement in such transactions, the average size of private equity deals in China is smaller than in the other Asian countries but the most numerous: they averaged 50 million dollars from 2008 and 2010 and recorded 150 deals early. For what concern the transactions, the deal sizes slowly tended higher over time even if is still dominated by small and mid-market companies with an average deal value of less than 20 billion dollars which cover almost the 70% of the total value during the last decade.

Over the 2000-2010 time frame, the transactions grew at an annualized rate of 53% [Figure 13] between 1-2 billion dollars per year, reaching a peak of nearly 18 billion

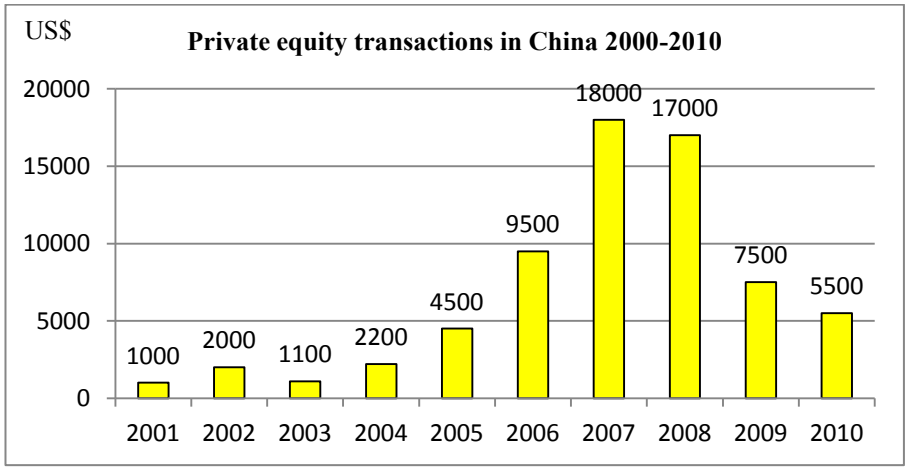

Figure 13: Private equity transactions 2001-2010 (annualized in US$ millions)
Source: Thomson Reuters

dollars in 2007 making the cumulative value of private equity deals more than 70 billion dollars under the span of time taken under consideration. While activity in the biennium 2009-2010 has moderated, the increasing interest in private equity activity in China is still considerable even if the most limit factor of such market regard the relative difficulty of deploying significant amount of capital in high quality deals which might be the main goal to achieve in a medium term prospective.

3.3.1 IPO: the major driver for expansion plans

The Initial Public Offer is the preferred exit route used by the investors. Private equity firms turn into IPOs because China's stock market provides higher P/E multiples thanks to the considerable liquidity in the market making public offerings more profitable. Moreover, China is considered a growth market plenty of small med-sized companies consequently IPOs represent the best option for accelerating the enterprise's expansion plans, solidify strategic planning, improve margins, increase revenues, search new shareholders capable to provide management and financial aid, proving they are able to operate at the level required for publicity listed organizations.

Differently from the developed economies, trade sale is the second suitable channel with 8 companies using this exit typology in the last 24 months compared with 28 occurred with IPOs. The forecast analysis over the next 24 months expect around 15 trade sale and more than 50 IPOs as a clear reflection of the increasing maturity of the industry in China.

Another peculiarity of the Chinese market consist in a low presence or even a lack of turnaround operations as well as write off due to a steady increasing and solidity of the domestic economy far away from the uncertainty and critical economical troubles widespread throughout Europe and in particular in Italy. Thanks to a dynamic capital market, IPOs are best channel to generate the higher profit in the shortest time than the other exit routes: the time between a private equity investment and an IPO averages about 2,1 years respect almost 3 years for the main other strategies practiced in the mainland

China and 3,7 and 4,8 in US and Europe, respectively. However, instantly a portion of shares are available for sale to the public in order to involve more shareholders as possible in order to make the company's expansion plan concrete, and in a second time disinvest the remained amount of participation after the lock-up period ends. When it comes to selling the remainder of the shares, timing varies depending on the stock's performance.

3.4 The rising of renmimbi funds

Over the last years, the Chinese market has experienced a set of laws at the national level capable to shape the China's private equity landscape. The first deals were aimed to encourage the venture capital enterprises involved in the China's high tech industry. In 2003, another intervention allowed foreign equity investors to form Renmimbi private equity funds for the first time as foreign invested companies limited by liabilities or set up cooperative joint ventures without legal person status.

A giant leap has occurred in 2006, when the central government enacted the Partnership Enterprise Law which admitted limited partnerships just for domestic investors while or the Foreign Partnerships Measures must be wait the State Council approval at the end of August. The promulgation of the Partnership Measures is a very welcome developed for the private equity industries and alternative investment sectors in China even though still persist visible differences aimed to promote Renmimbi (RMB) private equity funds in order to implement the rapid emergence of China's local market keeping under control the widespread of foreign US dollar-denominated funds.

Since 2008, there has been a dramatic shift to RMB fund raising thanks to several key drivers factors as follows: local firms enjoy privileges over foreign rivals, government support for the local private equity industry through a easier and faster funding and exit opportunities, etc. Furthermore, the active government support and a growing regulatory framework, made of a considerable set of laws, are currently oriented in creating a vast new pool of capital for private equity investments, approving new institutional investors, provincial government organizations, pension funds, insurance companies and other new sources of capital.

As a consequence, Chinese firms in the private equity landscape invested 7,8 billion dollars last year, overtaking for the first time the 7,4 billion dollars by US and European funds as it demonstrated from the Asian Venture Capital Journal analysis.

However, these data should be handled carefully. Even if at a first glance seems the Chinese firms are becoming self-supporting in the whole fundraising process, nothing is more wrong. Behind the 7,8 billion raised there is the presence of the leading Western private equity houses (Blackstone and Carlyle Group in primis) which raised the capital needed with the entire amount of capital coming from the Chinese domestic market as well as in according to the fulfillment of the Chinese law. Thus, the presence of foreign private equity investors is strictly necessary to spread, within the country, their competencies and skills gained through a long experience.

The fundraising process goes hand in hand with the investment activity [Figure 14]: Chinese funds represent a significant and growing force in China, representing a remarkable 64,1% overall commitments in 2009, and 80,2% of total commitments in 2010 compared with a 35,9% and 19,8% reached by the US dollar fundraising in the same years under consideration.

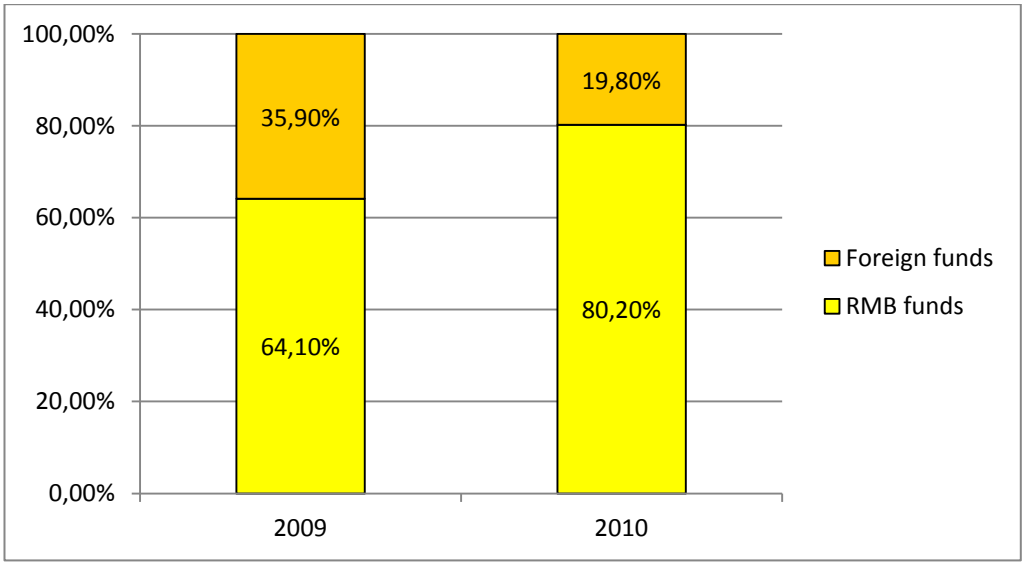

Figure 14: RMB-denominated versus US-dollar fundraising between 2009 and 2010
Source: Asia Private Equity Review

Another interesting reason, worth to be mentioned, about the favorable treatment reserved to domestic funds regard the wider range of investment opportunities they are allowed to undertake, including the ability to invest in sensitive industries such as defense and media, which are off limits to foreign investors.

Notwithstanding the Yuan-denominate funds are characterized by numerous advantages for domestic managers, however, still persist structural issues that could eventually overshadow some of their advantages, especially for the international limited partnership institutions. The most significant among them is the possibility that a sizable percentage, if not all, of the capital committed to the fund is drawn down at the beginning of the investment period resulting in a sharp contrast with the European and American-style funds where commitments are generally called over a period of several years.

Consequently a huge pressure is directed to the general partner of the fund to invest the amount of money raised at a faster pace than has traditionally occurred. Today, this intervention should be just a potential threat for foreign investors even if the main line of thought is optimistic that the government will allow some flexibility in order to improve the quality of such deals within the Chinese market thanks to the deep knowledge experienced in this field by global private equity firms.

3.5 The Chinese legal environment for private equity investors

Since the early 2000s the Chinese legal framework has experienced prompt administrative measures to attract foreign private equity investors looking to run their activities in China. The legal environment background is mainly divided into national and local legislation. Both rules have been created to encourage foreign private equity investments.

The first national measure could be traced back to 2003, when came into force the Administration Measures on Foreign-Invested Venture Capital Enterprises, known as FIVCIE, for foreign as well as domestic investors willing to develop China's high tech industry. The FIVCIE measures are addressed to form, for the first time, Renmimbi private equity funds as foreign invested company characterized by limited liabilities or joint

ventures without legal person status. In order to gain a limited partnership, companies have to wait till 2006 when the Chinese government enacted the revised Partnership Enterprise Law which gave the possibility for Chinese companies to established limited partnerships; for what concern foreign investors, the limited partnership was possible to obtain only though the State Council provision. Only at the end of 2009 the latter promulgated an act aimed to extend the limited partnership to any other foreign investors.

Instead, the local legislation are generally enacted in the areas of municipality relevancy, an urban administrative division having corporate status and self-government decision powers. Among the most relevant Chinese municipality laws willing to encourage private equity investments, should be mention the Tianjin, Shanghai, Beijing governments which issued several regulatory. Just to mention a few: the Pudong PE Management Measures, the Pilot Program (the most relevant), the Beijing Investment Management Measures, etc.

Even though the recent progressive demonstrates breakthrough legislation, still exist some various legal limitations for foreign private equity funds willing to invest in China as it underlined in the previous paragraph.

3.5.1 The Pilot Program for Foreign-Invested Equity Investment enterprises in Shanghai

The Pilot Program Measures represent one of the main successful local legislation throughout China. Notwithstanding it has been running since February 2011, the new Pilot Program is considered a giant leap in order to implement China's effort to set up an effective framework for foreign private equity investment in RMB funds even if still exist various issues to solve.

However, this program offer a clear and exhaustive legal framework for private equity fund managers willing to convert their home currency to Renmimbi to fund capital commitments to sponsored RMB funds as well as permit foreign investors to invest in.

Moreover private equity fund managers are allowed to provide consulting services to sponsor RMB funds and attract, in this way, the largest number of clients.

Under the Pudong (a Shanghai District) Private Equity Management Measures, private equity foreign houses can be founded through the comply of the following requirements:

- Set up a limited liability company as a legal form;
- At least 2 USD million as a registered capital: 20% to be paid within three months the fund managers receive the business license and the rest within two years;
- At least one shareholder or affiliate with a relevant experience in private equity business;
- At least two senior managers with minimum two years of experience in private equity investments;
- A private equity fund must be subscribed with at least 15 USD million to be contributed in cash and the capital subscription have to be signed with the foreign investors name and each limited partner must contribute at least 1 USD million.

Another particularity of such program regard the Qualified Foreign Limited Partner (QFLP), which have to meet more rigid requirements like holding at least 500 USD million in assets or manage at least 1 USD billion of assets, a solid governance structure and no record of regulatory sanctions in the previous two years and at least five years experience in investments within China.

In conclusion, foreign Private equity funds present some restrictions because they are not allowed to invest in prohibited industries, secondary market stocks and bonds, futures or other derivatives, real estate and lend/provides guarantees to third parties.

3.6 A comparison between the Chinese and European economic policies

A curious aspect why the Chinese government encourage foreign companies to invest in the mainland of China does not regard the capital contribution because the country foreign reserves are 2,4 trillion dollars, definitely enough to finance the domestic market, but the blend of skill sets, contacts, expertise, technology, etc. Consequently private equity operators are seen, in China, as a value-adding technique and a value-added resource differently from the nowadays line of thought widespread in developed countries

where such operators are criticized for the aggressive profit policies oriented pointing out them as one of the major causes generating the global financial crisis. During the last decade seems the economic equilibrium between Europe and China has been role-reversed also for what concern the private equity market. In the past China was considered one of the center of anti capitalism through a widespread government participation within the domestic economy and Europe as the hub for economic liberalism policies.

Today, the trend has been inverted because China encourage foreign investments, private entrepreneurship activities, private investments in public equity thanks to a government positive attitude towards an openness line of action. The latter are identified with the introduction of RMB – denominated funds in order to promote the domestic investors activity, a closer alignment of domestic regulations with international principles, collaboration with global funds to diversify portfolios, introduction of industry best practices for both limited and general partners operating in China, and higher levels of participation by domestic institutional investors and fund-of-fund investing in private equity.

Differently, Europe (including Italy as part of it) is carrying out several interventions in the economy through restrictive economic and fiscal policies in order to keep under control the national debt without stimulating the growth. Moreover, in Europe private equity is under challenge due to a strong line of thought extremely hostile as it shown from the statements of finance ministers and member of the general public joining the European Union. Putting people out of work, asset stripping, paying too little tax (through an increasing of the amount of debt finance which is tax deductible and reduce the amount of equity which is not tax deductible) and overpaying the managers who runs these organizations are the main reasons why the corporate finance circuit does not work anymore. Even, a little percentage of the common opinion claim the government interventions into private companies in order to create state owned enterprises as it was one time under the Chinese communist government.

In conclusion, the Chinese policies are definitely supporting a liberalism economy-oriented as a result of the globalization process where the private equity investments play a

fundamental role in order to integrate the domestic market with the foreign ones conversely to what is happening in the developed economies.

3.7 The Chinese economy is going private: the role of private equity

By the late 1970s, China adopted the twin policies of opening its market to foreign trade and investment and begin a reforming program for state-owned enterprises. In line with the first policy a giant leap has been made in order to open its market to a process of international integration as it already talked about. Regarding the second policy, China has taken a gradual and selective approach for reforming the state-owned enterprises due to their poor financial performances compared with domestic private enterprises and foreign multinationals operating in China. Nowadays the state ownership accounts for the 35% of the entire Gross Domestic Product but, in spite of everything, it still remains a fundamental, if not dominant, part of the country's economy after thirty years of economic reform. In terms of enterprises number, at the end of 2008, 154000 SOEs only accounting for the 3,1% of the entire companies located in China even if they control the 30% of the total economy assets. Consequently, in terms of average assets, SOEs are equal to 13 times the non-SOEs companies. However, the State is never far away from the strategic assets as it testified by the table [Figure 15] reported below which was taken by The Economist journal published on the 3rd September 2011:

The invisible hand

Private and partly privatised Chinese companies, selected

Category	Description	Examples
Large state-controlled enterprises	Usually monopolies or oligopolies. Minority shareholdings sold in public offerings	ICBC, China Construction Bank *(banking)* China Mobile, China Unicom *(telecoms)* China National Petroleum Corp *(oil and gas)*
Joint ventures	Frequently involving foreign partner, providing technology in return for market access	Shanghai Volkswagen *(cars)* Xian-Janssen *(biomedical)* Denghai *(agriculture)* DHL-Sinotrans *(logistics)* Ameco *(manufacturing)*
Private companies with some state influence	Often in new markets with no state-owned enterprises. Encouraged by friendly government polices and obstacles to foreign competition	BYD, Geely, Chery *(cars)* Goldwind *(energy)* Huawei *(telecoms)*
Companies backed by publicly owned investment funds	Investors include foreign private-equity and venture-capital funds as well as city and provincial governments	Shanghai Environment Group, Nanhai Development *(environmental protection)* Digital China *(IT services)* China WLCSP *(chip technology)*

Figure 15: The State influence within domestic economy
Source: McKinsey, Infinity Group, The Economist

Notwithstanding the State control the main key sectors which generate huge profit (banking telecommunication, oil and gas, energy, automotive, etc.) still exist feckless state-owned companies that are becoming private in order not to fail.

Consequently, domestic and international private equity operators are necessary for re-launching underperforming companies as a result of the Chinese government to keep inefficient state-owned enterprises. Even though the latter are focused on absorbing surplus labor and help to maintain social stability, which is crucial to the successful functioning of the entire economy, in a medium-long term prospective the lack of competitiveness will bring the country to a slower growth.

The benefits of privatization are coming from the gain obtained by the reduction of managerial expenses to sales, a better knowledge and experience in specific business sectors, improve labor productivity as well as making successful investments.

Over the past decades, the Chinese government grants private organizations more commercial freedom and approve legal and financial framework essential to a market economy due to the tremendous challenge the SOEs have to face in developing competitive strategies, renewing their organizations, restructuring their financing and dealing with a fast-changing regulatory environment. Therefore SOEs must also contend

with active new competitors, both local and international as a result of a broaden globalization program.

While this is hard for Chinese government, private firms as well as multinationals companies have unique opportunities to acquire or merge with SOEs in order to help shape China's transformation thorough revitalizing the ownership structure. In addition, due to a transitional macroeconomic environment in which state-owned enterprises operates, the economic policies are definitely changing as China is moving to a market based economy though its 5 year programs oriented on giving much more autonomy to both provinces and enterprises located in the coastal side as well as in the inner lands.

The latter represent another important factor for equity investors to catch business opportunities in the less developed areas of China where a huge amount of natural resources are located (minerals, energy, oil & gas, etc.). To support such investments the government is still allocating numerous incentives that should be unexpended also by domestic and international private investors.

In line with these policy, investment opportunities are accessible not only for renown and well-off private equity operators but also for small-midsized companies with limited funds interesting in expanding their business in the regions like Sichuan, Chongqing, Tibet, Shaanxi, Inner Mongolia, Guanxi, etc. where less capital is required for undertaking investments.

3.8 How the private equity industry can shape the Chinese economy

The private equity industry, still a relative phenomenon in China, continues to develop rapidly and through their investments contribute to China's long-term economic and development goals. In the following paragraph is described the way the private equity firms have continued to transfer management know-how to their portfolio businesses, build globally competitive companies, improve corporate governance develop an innovative private sector in substitution of state owned enterprises, support development inland and foster domestic consumption. The analysis reports important data regarding the positive

social and economic impact of equity investments carried out by private equity backed firms compared with publicly listed firms.

3.8.1 The social impact of private equity in China

Private equity has a significant social impact on China's economy as demonstrated by the analysis illustrated below which involve companies over a two year period starting in 2009 and ending in 2012. There are several factors capable to influence the social environment within China and the main ones are the following:

- improved job opportunities and innovation: private equity backed firms are job creators, adding full time positions at an annual rate of 8%, even so the wages are continuing to rise at 7% [Figure 16] higher at private equity portfolio companies compared with listed companies, contributing to a greater standard of living for employees, encouraging a increased consumption. Furthermore, the average annual base salary for employees hired by private equity operators is both higher and rising more quickly than at publicly firms. The participants involved in the survey carried out by the management consulting firm Bain & Company, in partnership with the European Union Chamber of Commerce in China, reports that the base salary provided private equity funding is more than 51000 RMB compared with an annual salary of approximately 41000 RMB offered by listed firms as well as the gross salary growth rate is also higher recording a 7% more than the competitors.

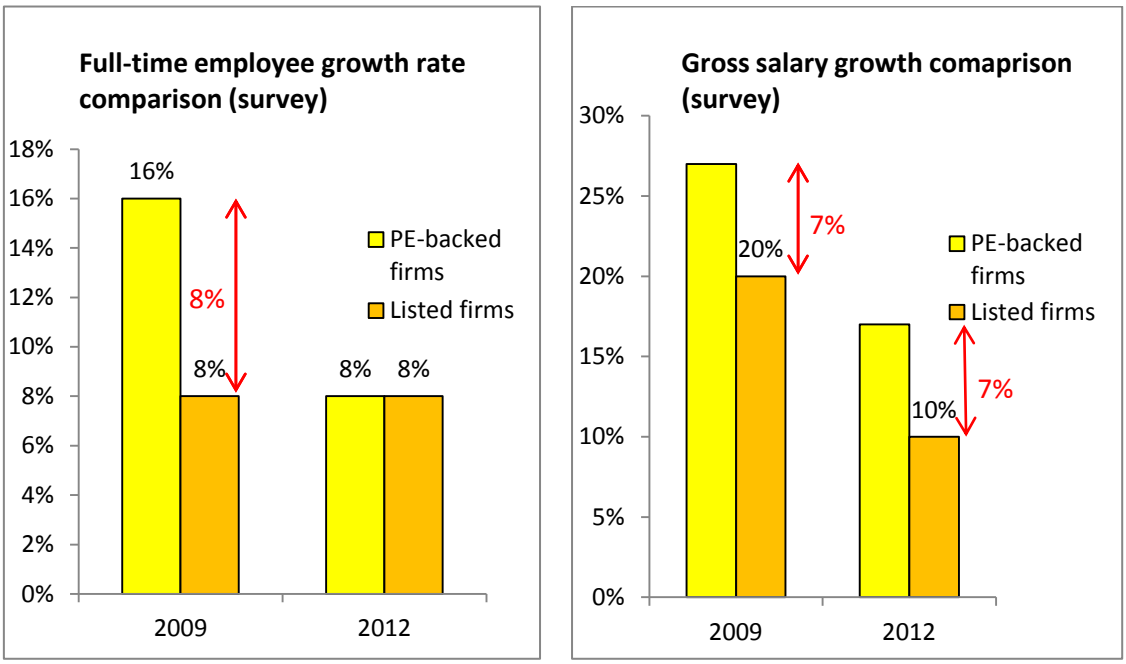

Figure 16: Improved job opportunities and rising incomes for PE-backed companies
Source: ACVJ, Wind, Bain analysis

Private equity's higher wage is oriented to attract quality talent, especially at a managerial level, as it testified by the almost portfolio executives interviewed. Once the fund's operators acquire the target company, they replace some management-level personnel with more qualified and competent staff found through professional headhunting firms in order to improve the company's performance.

- Increased R&D investments: private equity backed firms strongly stress the importance of investing in research and development programs to ensure a steady growth through innovation. Measure as a percentage of revenue, the 2012 survey shows the fund's operators spend almost twice than the publicly firms, whose investments decreased by 16,6% over the same span of time. Investing in new technologies demonstrates how a sustained emphasis on innovation might establish China as a leader society. As it shown from the graph below [Figure 17], private equity investors stimulate innovative enterprises and improve the effectiveness in R&D investing an ever greater percentage of revenues in order to provide the target company a competitive advantage.

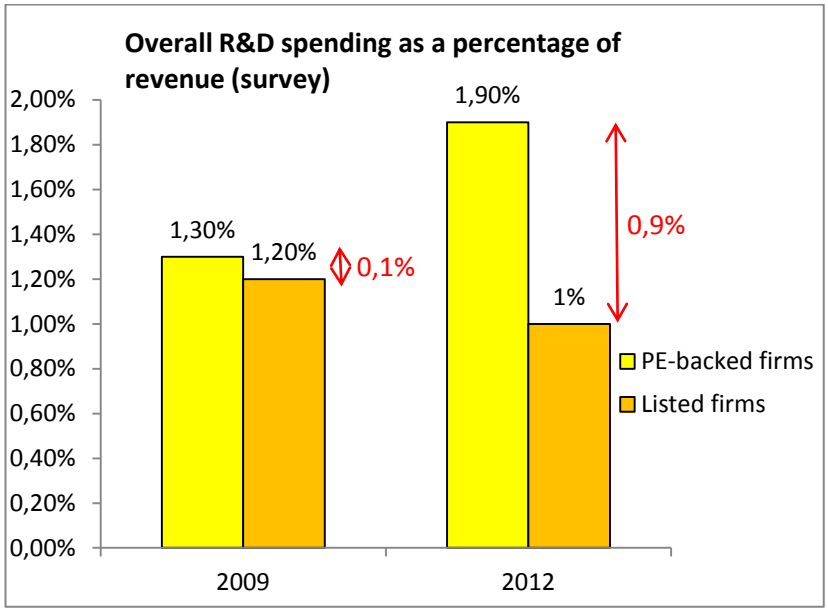

Figure 17: Overall R&D spending as a percentage of revenue
Source: ACVJ, Wind, Bain analysis

Through a steady increase productivity of R&D investments, almost half of the companies surveyed underline the positive contributions of private equity operators to R&D comprehending the introduction of systematic toolkits, management know how, for identifying the best practices to adopt in different situations every single company is dealing with.

- Corporate social responsibility: both private equity backed and listed firms pay attention about green initiatives even if corporate commitment to environmental protection is in early stage. Only a 40% of the surveyed sustain that fund's operator are focused on value added initiatives and at the same time on compliance issues even fewer address their expenses for environmental protection. Even though the green initiatives are a minority, slight signs of involvement are becoming more concrete within China's economy.

➢ Go West: the last but not the least topic supported by the private equity firms regard the China's "Go West" policies. The main goal is to encourage investments in China's underdeveloped inland provinces located in the western and central part as well as Tier 3 cities. These policies began in the early 2000s when the Chinese government initiatives will to disclose its efforts to develop the poorest regions where huge potential are still hidden. In fact energy and minerals resources are abundant and in a near future necessary for the domestic economy's growth.

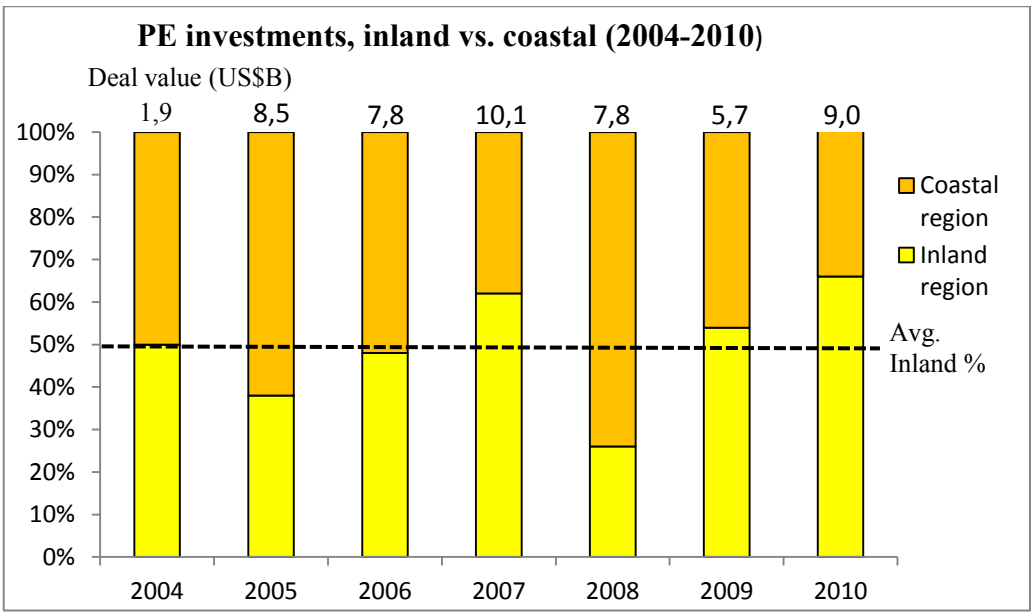

Figure 18: A comparison between inland vs. coastal investments
Source: ACVJ

This analysis consider as inland regions the following: Xinjiang, Tibet, Guizhou, Yunan, Gansu, Qinghai, Ningxia, Sichuan, Chongqing, Shaanxi, Inner Mongolia, Guanxi.

The inland investments [Figure 18] are in steadily grow even if in 2008 they dropped off due to global economic uncertainty that affect the worldwide investments. Although such turning point, the private equity investors' interest quickly rebound even reaching almost the same amount of money invested in the pre-crisis period. Since 2009, more than

half of the whole investments are concentrated in the underdeveloped areas surpassing the businesses carried out in the more affluent coastal provinces.

The most unexpected data regard the deals in Tier 3 cities: they grew dramatically from 1,2 billion dollars to 2,8 billion dollars.

In conclusion the most challenge the Chinese economy have to face is balancing the country development in its whole territory otherwise the domestic economy will record. Consequently the private equity firms play a fundamental role for the wellness of the China and its population.

3.8.2 The economic impact of private equity in China

As well as giving a positive social impact, the private equity operators strongly influence the target companies economic performances. The analysis cover deals carried out during the period from 2004 to 2008 which involve a panel of companies that represented 40% of the entire value of private equity transactions occurred in China.

Moreover the main companies surveyed belong to small to mid-sized segment, with revenues of less than 10 billion RMB. This report will to provide, through a quantitative analysis, the positive contributions of private equity operators to the country's economy that no other listed firms or even government institutions are able to ensure.

- Guarantee satisfy financial performance: private equity backed firms outperformed compared with publicly listed firms. Higher profits and growth are the key factors that make successful and well considered the private equity industry in China. The revenue growth rising an average of 21%, an impressive gain from just 3% of the 2004-2006 data compared with publicly traded peers [Figure 19]. The profit growth in the last biennium is diminished from 14% to 7% due to a higher spending on R&D, taxes and employee compensation as well as rapidly acquire the needed property, plants and equipment which are strictly necessary for future growth initiatives.

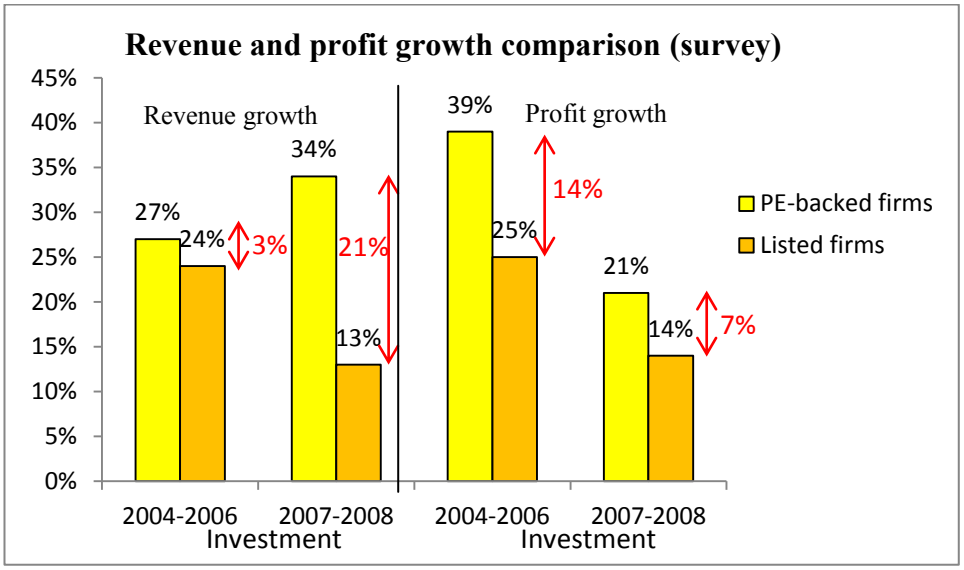

Figure 19: A comparison between PE-backed and listed firms regarding financial performance
Source: ACVJ, Wind, Bain analysis

Even though portfolio companies continue to generate higher profit growth than listed companies, the profitability decline is explained by different approach to private equity investments. In fact the sectors to invest in are definitely shifted: more of their funding are addressed to industrial goods and services, retail and healthcare sectors rather than financial sectors, technology, media and telecommunication. Notwithstanding these industries record a faster growth than any other sectors, they also require huge fixed-asset investments that strongly diminish the profits.

- Provide critical support for smaller companies: small and mid-sized companies are the engines of China's growth, representing the 90% of the whole companies in the domestic market and account more than the 60% of the total county's Gross Domestic Product. Private equity firms have the greatest impact among smaller companies. The ones which record less than 1 billion RMB revenues growth at a 71% yearly rate compared with a 26% of listed companies. Companies with 1 to 10 billion RMB revenues grow at a rate of 33% (19% for listed companies) and companies with more

than 10 billion revenues attest 27% growth rate compared with 17% for publicly traded peers.

- Improve corporate governance and spur growth: the almost executives of private equity portfolio companies affirm they benefited from the role cover from the firm as management and financial advisors. The main areas of interested where executives rely the private equity operators is due to their capability to strengthening corporate governance processes [Figure 20], creating a more clear and transparent decision-making processes and efficiently reallocating working capital to encourage the expansion stage.

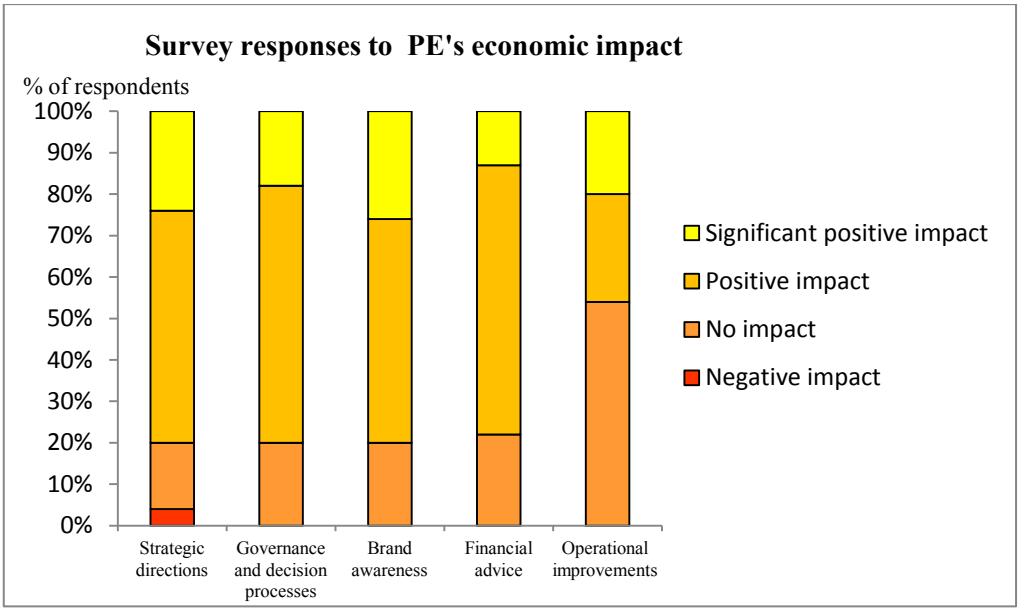

Figure 20: Survey responses to PE's economic impact
Source: Bain analysis

Thanks to its brand awareness, the private equity operators use their network to get in touch with renown customers, suppliers and distribution channels and make the target company more international with foreign investments. The last two aspects record an inverted trend: the financial advice are characterized by significant and positive impact of fund's operators compared with the operational improvements where their impact is not perceived as in the previous aspects of analysis.

As proof of the stronger performance, the target companies pay more taxes than the listed firms due to the higher profits generated. More in detail, in 2009 private equity backed firms yielded tax payments grew to an annual rate of 28% compared with 18% recorded by publicly companies.

- Support the expansion of the China's consumer goods and retail industry: private equity operators shift their attention to these sectors giving a positive impact on overall domestic consumption and sales [Figure 21].

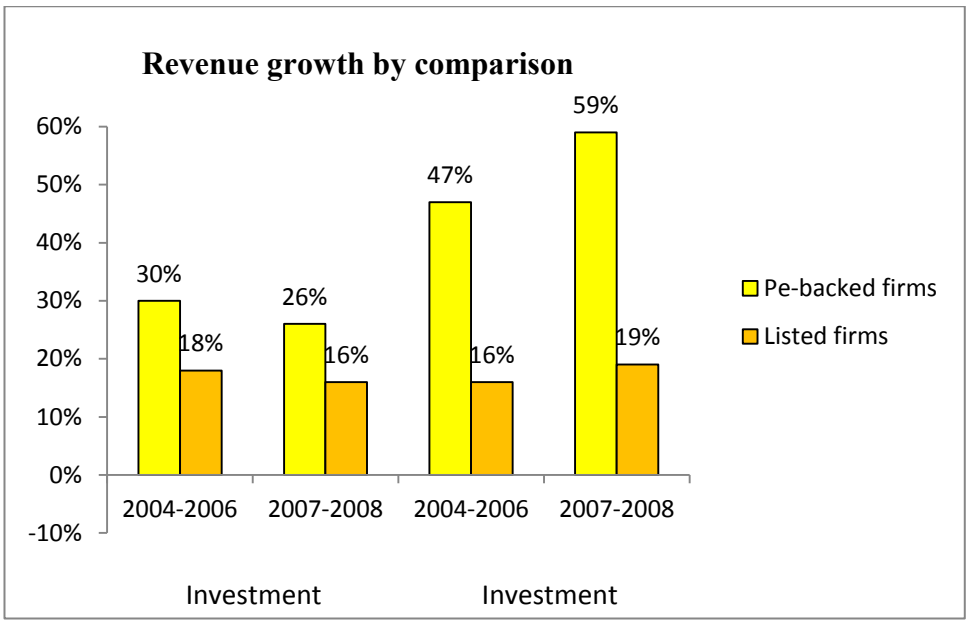

Figure 21: Revenue growth by comparison within consumer goods and retail sector
Source: AVCJ

In 2010, the transactions in these two sectors covered the 13% of the entire private equity deal value compared to the 4% represented in 2004. Private equity backed consumer goods firms attested annual revenue growth of 26% , slightly decreasing from the previous years, while listed companies saw growth at 16% and 18%, respectively. However the main performance gap between private equity operators and listed firms exist in the retail sector. According to the 2009 survey, retailers private equity operators booked sales

growth of 59% compared with just 19% for publicly listed peers, as it happened in the 2004-2006 investment period with an annual growth of 47% and 19%, respectively.

4 OPPORTUNITIES OF BUSINESS AMONG THE CHINESE AND ITALIAN PRIVATE EQUITY INDUSTRY

4.1 Introduction

This chapter analyzes the main motivations driving Chinese outward investments in Italy and vice versa. All the data collected are based on primary, secondary sources and in-depth interviews carried out with key informants and managers belonging to Chinese companies located in Italy.

Chinese equity investment in Italy is a recent and limited phenomenon even if it shows some interesting features. Thanks to the following empirical study, it is possible to describe how the Chinese pattern evolution of entry to the Italian market is the same adopted by Chinese firms for investing in other European countries. In fact, this technique is united by primary investing in modest and small activities and secondly acquire tangible and intangible resources retained desirable to increase the Chinese market share as well as upgrade its technological and production capacities.

However, during the last decade Chinese investment in Italy reflects a kind of reverse "Marco Polo" effect. Marco Polo was a well-known Venetian merchant and traveler who visited China around the thirteen century in order to bring back from an advanced civilization some useful discoveries for the Italian culture (such as the use of the compass, coal, paper money, etc). Nowadays, the Chinese companies will to acquire Italian firms because of the original knowledge being developed in Italy economy, frequently linked to design-intensive and high-quality products.

These acquisitions are becoming more and more attractive for Chinese investors due to several reasons like the financial troubles affecting the developed countries, the weakness of the Euro and the near-paralysis of Italy's domestic banking system reluctant to lend money to local firms.

Therefore Chinese multinational enterprises are investing in Italy to get access to local competitive advantages in several sectors such as automotive, chemicals, luxury goods, manufacturing, mechanical, home appliances, etc. The location choice for

investments are often concentrated in the strategic "industrial district" located in the Northern Italy, where new technologies are developed and improved in technology clusters. Moreover, the investment location is identified close to these clusters or in proximity of university-based research, in order to tap the local competences available.

Regarding the Italian investments in China, countless opportunities are still hidden in the inland regions where is located the China's next booming market for Italian companies thanks to the already mentioned "Go West policy" undertaken and supported by the Chinese government through economical incentives. A territory where the new Chinese consumer is taking shape, still geographically dispersed and culturally diverse. It is the place where international brands still little know and where the big challenge is to understand how to create a bond, a communication line with these new consumers, also leveraging emotional and cultural connections. In order to conduct successful investments, are briefly described different entry mode that might be used by Italian companies to expand their business in China according to their features.

However, China, as well as offering numerous business opportunities for Italian investors also reserves some threats. One of the hardest challenges the Italian investors have to face to get into China regard the cross cultural differences: at a first sight they might be considered as a tricky obstacle to overcome but, if understood and exploited in the right way, it results a font of competitive advantage. Among them, the most influence and concrete factor widespread in the whole Chinese culture to keep under consideration for foreign investors is the concept of guanxi, which roots are even traced back to the traditional Confucianism culture.

In conclusion, this work ends with a particular focus on the Italian experience in Suzhou, a prefecture-level city located in Tier 2. In this area is concentrated the most considerable Italian business community in China due to a series of positive variables, that mixed together, make foreign investments deserving every single yuan.

4.2 OPPORTUNITIES FOR CHINESE INVESTORS IN ITALY

4.2.1 Motivations for Chinese foreign direct investment

The Chinese foreign direct investment in Italy are mainly oriented in the following way:

- defensive market-seeking in order to secure a position into a market,
- offensive market-seeking to invest in new markets;
- strategic asset-seeking to acquire technologies, managerial capabilities, brands, distribution channels;
- efficiency seeking to try the maximum advantage from the economy of scale/scope and find out the cheaper input factors in particular for labour.

Another reason why the Chinese market seeking abroad is the excessive competition in the domestic market which is plenty of Multinational Enterprises (MNEs) entering and investing in China. Consequently profit margins fall culminating in overcapacity within the manufacturing industry, pushing Chinese companies to sale their products abroad through appropriate distribution centers as well as to establish overseas productions factories as one of the main criteria for internationalization.

Even though in developed countries access to market is really complex, the blend of negative conjuncture factors affecting the European countries make this investment more concrete.

Among the factors attracting Chinese equity investments (especially in Italy), the most important is the access to technology, managerial and marketing skills, established brands and reputation. Evidence of the transactions happened over the last twenty years in Italy confirms that the need to obtain advanced management skills is the key reason for Chinese internationalization in order to overstep the cross-cultural differences occurred between Italy and China. Further empirical studies of these motivations are provided on the white goods sector involving the main Chinese firms.

In Italy, the importance of the strategic asset seeking motivation, by Chinese companies, is testified by the intensification of cross-border merger and acquisition

(M&A) activities carried out by Chinese firms as well as joint ventures. In fact, M&A are aimed to speed up acquisition and control strategic asset.

However, set up wholly owned subsidiaries are the preferred choice when asset-seeking motivations prevail and the host industry market is high competitive, while joint ventures (in the most cases are equally alliances) are adopted for establishing first or earlier- mover advantages in market characterized by a high growth. According to Zhang and Filippov (2009) studies, private companies find profitable to internationalize their business through strategic alliances followed by direct investments in the target companies due to the lack of the government support.

Even though the increasing number of Chinese investment in Italy, making profitable transactions is a daunting task because is necessary to make a carefully analysis in order to face the potential threats that may be are hidden within the domestic market.

Moreover, the Chinese investments in Italy are driven by a sustained effort to enter competitive in the Italian market and get access to advanced technologies, know-how and competence.

The main motivations behind these operations within the country are the search for new markets and other trade-related activities (market-seeking), and search for strategic assets. The "defensive" and "offensive" market-seeking strategies characterize the entry pattern of Chinese firms in the Italian logistic sector, the seek of sophisticated assets and new markets concern the home appliance sector, the asset-seeking motivations by Chinese companies are focused on the automotive, sport, garments and luxury goods sectors.

Regarding the logistic sector, the economic policy is moving from a defensive to offensive market-seeking investments. Especially the maritime transports hold a crucial role within the Chinese economy, since the major part of the traded goods are shipped through the use of ports. By the end of the 1980s, this sector rose sharply due to a set of laws enacted by the Chinese authorities to modernize the domestic harbor infrastructures and the merchant marine conscious of the enormous potential not yet exploited. As late entrants in the foreign trade worldwide market, initially Chinese firms were mainly inclined to seek joint-ventures and alliances with local enterprises. More recently, due to the new capabilities and market skills acquired over time, Chinese companies tried to

extend their position through investments in infrastructural projects. Accordingly, the first Chinese investments were involved in a “defensive” investments aimed to consolidate commercial relationships with the host countries. Recently, the economic policy has been changed: the strategy is oriented to “offensive” investments focused on the new market acquisition and the search for more advanced capabilities.

This model is the more realistic sample of the entry strategy used by Chinese companies to get access to Italy. The country is well paced geographically thanks to its suitable position in the Mediterranean Sea providing easy access to both southern, central and northern Europe. China Shipping Company (based in Shanghai) and China Ocean Shipping Group (COSCO, Beijing), both among the top ten shipping companies worldwide, have invested a lot of resources in Italy. COSCO established in 1995 a terminal in the port of Naples in joint venture with the local operator CoNaTeCo which is the main container terminal operator in the Port of Naples and is still heavily investing in the port of Genoa. In the harbor of Naples, COSCO has recently obtained the permit for a project to build a new terminal for container, after a long delay due to bureaucratic issues.

Likewise, the China shipping company invested in the port of Genoa (1999) and established a commercial office in order to coordinate the activities widespread in the all maritime agencies and expand its market share in the Mediterranean and Black seas.

Notwithstanding the Italian logistic sector is plenty of opportunities for foreign investors, exist some signals of excessive red tape that represent a deterrent for further investments.

With regard to market-seeking investments, Italy represent a relevant market for foreign investors, being the 7th largest economy worldwide. In a sector such as telecommunications, Italy record the highest rate of mobile penetration in Europe (151,35% with 90,61 million subscribers in total in December 2009) therefore the country reserve numerous opportunities for making business. Huawei, the second largest telecommunications equipment maker in the world, established three subsidiaries in Italy: Rome and Milan in 2004, and afterwards Turin with a centre for product design, R&D department on Microwave technologies and testing.

The main reasons driving Huawei's decision to invest in Italy are related to the size and potential of the market. Chinese companies consider Italian consumers to be demanding and at the same time particularly sophisticated. Consequently the Italian market is strategic in terms of taste and feedback on goods as well as seen as a test market, in sectors like home appliances, for products adapted to European tastes.

Among the market related activities, the market-seeking investment in Italy prevail on the other ways used by Chinese companies to land in the country. Between 1986 and 2009 these kind of entry pattern is used by 38 companies out of 68 projects, according to the classification provided by Sturgeon (2008). The investment's aim is mainly focused on serving customers and to strengthen loyalty through supporting services and marketing offices. These are the cases of Termax, a state-owned traded company which opened in 1991 an import-export office in Milan, and Suntech Power Holdings, the world's largest producer of solar panels. Suntech Power opened in 2008 a sales office in Milan and also is still investing in Italy motivated by the large growth potential offered by the Italian market and by the favorable incentives provided by the local government.

Haier is another sample of Chinese company heavily investing in the Italian white goods industrial districts in order to develop market and strategic asset seeking activities within the country. In 2011 Haier became world's largest home appliances producer and the first company to enter in Western market as an own equipment manufacture exporter.

However, the company needed funds to undertake its expansion strategies consequently the private equity houses Bain Capital, Blackstone, Carlyle provided capital and especially management skills to face this ambitious program. In Europe, the first move by Haier had to be traced back to 2000 when its headquarter was established in Varese.

The decision to locate the headquarter in Varese is related to the local presence of a strong industrial district specialized in white good sector. The agglomeration of specialized firms generates positive externalities due to the presence of high-skilled workers and suppliers of particular components.

Then followed the acquisition of Meneghetti (2001), a manufacturing plant producing refrigerators, and Elba (2009) which produces cooking appliances. Both

companies are located in the region of Veneto where is based another relevant industrial district for home appliances products.

These acquisition were driven by three reasons: overcome the EU tariff barriers, develop the capacity of design aimed to be sold within the European market and in the high end Chinese import market, and finally acquire the knowledge and managerial capacity to overcome the cross-cultural differences among Italy and China.

Merely market-seeking oriented strategies, within the Italian home appliances sector, regard the Chinese giant firm producing air conditioner and refrigerators. This is the case of Hisense. In order to build a commercial image and promoting the Chinese market throughout Europe have been opened an office in Turin and a production plant in Grosseto.

However, among the key factors driving the Chinese foreign direct investments the asset-seeking motivations secure the access to certain types of valuable assets by participating in a foreign market as the Italian one. The sectors involved the almost Chinese capital are the automotive, sport, garments and luxury goods where Italy has experienced a long tradition.

In sectors whereas China has not yet reached a full maturity consequently its investment are mainly targeted to acquire new capabilities, particularly in the highest value added activities. This is the case of the automotive industry. China is already one of the main carmaker producer worldwide (the first one measured by automobile unit production since 2008) thanks to the rapidly increasing internal demand and to the technology transfer from the main developed countries manufacturer, producing in China, to domestic suppliers for what concern subcontracting parts and components.

Recently Chinese automobile manufacturers have begun to produce vehicles through their own brands (Hafei, Lifan, BYD, Geely, Chery) which represent the 45% of the total output products and the rest are produced by joint ventures with foreign carmakers. The Chinese domestic plants are mainly specialized in niche markets where they do not feel under pressure by the leading Western (especially European) players. However, according to Noble studies the large Chinese car makers have also started to invest abroad in order to strengthen their position by acquiring control in established companies and even export their vehicles to new markets.

Italy has been targeted by Chinese investments as a suitable location for seeking advanced technologies and other related key competences. More in detail, the Turin area is considered the country strategic automotive cluster as it testified by the presence of Fiat headquarter, the leading Italian automobile manufacturer. In a broader sense, the whole Piedmont region experience a long tradition in the automotive industry concentrating in the different phases of the production process from design and production. Thereby, a skill network of suppliers play a fundamental role in order to provide the whole components needed by the automotive companies.

Consequently, both automotive and suppliers firms based in this fully-developed cluster attract the attention of Chinese companies like Jac Anhui Janghuai Motors and Changan Automobile Group. In 2004 and 2005, respectively, the two multinationals established their first overseas R&D and design centers in which Chinese researchers collaborate in strictly contact with the Italian counterpart made of local specialized firms and domestic research institutions. The aim of the investment is to implement the technical know-how, develop the style and exterior design of their vehicles and capturing the global automotive technology trends. Compared to the other European locations such as Germany and United Kingdom, the Turin automotive cluster offers excellent design skills, a pool of expert suppliers for outsourcing and a wide range of activities including engineering, modeling prototyping, mathematical analysis and calculation. These advantages are also coming from the strictly relations between the Polytechnic of Turin and Milan which are both specialized in scientific subjects linked to the automotive industry.

Remaining in the automotive context, in 2005 the Italian motorcycle producer Benelli, headquartered in Pesaro, was acquired by the Quianjiang Group, the China's largest scooter manufacturer located in Wenling, southeast China. Benelli was affected to a corporate financial troubles that brought it near to bankruptcy then Quianjiang Group invested two tranches of 26 million dollars in order to revitalize and relaunch the brand.

The main drivers of this acquisition regard the high-quality R&D facilities developed by the Italian brand during its centenary history and expand the firm's business globally, in particular in the East Asia. In fact, since then, Benelli J.Q. (the new company name) has inaugurated four stores in China and still searching strategic Joint Ventures throughout

Europe to product motorcycle components, such as pistons, suspensions, cylinders, connecting rods at a lower cost and higher level of technology.

Further asset seeking operations carried out by Chinese companies also involve the Italian sportswear, garments and luxury goods sectors. Within the textile and clothing sector, one of the biggest Chinese footwear producer, Wenzhou Hazan, acquired in 2007 the Italian brand Wilson. The Chinese firm maintains the design and production centers in Italy and ships its products in China.

In 2007, the Chinese apparel brand and supply chain services company Hembly International acquired, through its holding H4T, the Italian tennis-wear brand Sergio Tacchini for 27 million Euro also experiencing financial troubles, whose takeover was concluded successfully one year later. The acquisition was driven by the following reason: produce and sell, thanks to an injection of an extra 33 million Euro into the business, a wide range of its products in China targeting for the most teenagers attracted by the *Made in Italy* style.

The same pattern of entry in Italy by Chinese companies is even used in the luxury goods sector. In fact, Xinyu Hengdeli Group acquired Omas, an Italian historical producer of luxurious fountain-pens headquartered in Bologna. Moreover, Omas, over the last decades has become a reference on its market generating the 75% company revenues abroad. Thanks to this takeover, Xinyu Hengdeli has began an ambitious plan to expand its operations globally through geographic expansion of existing business as well as in the Asian markets, especially Greater China, where the Chinese firm its already considered a consolidated brand. Xinyu Hengdeli carried out this acquisition in order to capitalize Omas's assets and build a robust plan for brand extension into other accessories, hereby adding further writing instruments including in the brand collection.

4.2.2 Challenges and opportunities within the Italian market

The main disadvantages Chinese companies have to run into within the Italian market depend on structural factors such as the presence of enterprises specialized in traditional sectors (manufacturing, luxury goods, etc.) characterized by low R&D expenditure compared with the most developed worldwide economies and large size of the public sector have been pointed out by foreign investors as a huge disadvantage.

Other limits include poor infrastructure in Southern Italy, high levels of criminality activities in certain areas of the country and rigid labour market regulations. In a recent interview the former president of Cofindustria, Emma Mercegaglia, affirm that Italy is becoming less and less attractive for cross-border investment due to a slow justice, high taxes and a labour market plenty of constraints. According to the data collected by Eurostat on May 2012, throughout the European Union (and definitely in all Europe) the highest tax burden on labour are paid in Italy with a 42,6% taxation compared with an average of 34% in the other European countries.

The last but not least factors obstructing is the high and complex level of bureaucracy. As proof of the inefficient officialdom, the "Ease of doing business" ranking, (published by the World Bank), confirms the persistence of these constraints as it shown from the 65th position gained in 2009 compared with the 59th in the previous year as a result of the worsening conditions in workers' employment regulation, more lengthy and complex property registration and procedures, more expensive costs for obtaining construction permits.

However, recent empirical analysis underline that foreign investment in Italy present also strong advantages such as the suitable size of the domestic market made of small-medium enterprises (covering the 90% of the entire domestic companies with an impact on the Gross Domestic Product (GDP) of the 80%) and the lower labour costs relative to other EU countries. Other point of strength are the considerable location advantages linked to local specialization among agglomerations of firms that make foreign direct investment attractive in the same sectors. In particular, Italy is specialized in automotive, textiles and clothing, machinery, home appliances and such specialization may be considered for

multinationals located in emerging countries, like China, which represent a great opportunity to yield the relevant efforts undertaken to upgrade their production and technological capabilities. As it testified by the ICE Database (Istituto Nazionale per il Commercio Estero), an increasing number of investors coming from emerging economies are attracted by business opportunities in these sectors.

Countries	**% of Chinese investment in Europe (2009)**
Germany	25,65
United Kingdom	25,42
Netherlands	7,11
France	5,07
Sweden	4,78
Spain	4,40
Italy	4,05

Figure 22: Top recipients of Chinese foreign direct investment in Europe (excluding Russia) in 2009
Source: Elaboration of data collected within MOFCOM Database

Accordingly Chinese equity investment in Italy within a European prospective [Figure 22], hold the 7th position with a share of 4,05%, while Germany and United Kingdom account for a more than 50% of the entire Chinese foreign direct investment in Europe.

4.2.3 Characteristics of Chinese foreign direct investment in Italy

The first Chinese investment in Italy can be traced back to 1986, when Air China set up a commercial office in Roma. From the mid 1980s to the end of the 1990s investments were sporadic. The latter mainly included affirmed Chinese companies willing to internationalize their business in Europe, and more to the point in Italy due to its strategic position in the Mediterranean Sea giving easy access to both southern, central and northern Europe. In fact, in 1999 the Nanjing Motor Corporation established a representative office in Turin (1986) in order to manage the relationship with Iveco, the commercial vehicle unit of Fiat, in a spate of technology transfer deals evolved into an equal joint venture. Besides, in 1990s was opened a commercial office for Cemate Machinery Technology in Lombardy.

The Chinese investment in Italy also involve the banking sector were the Bank of China and, subsequently, the Industrial and Commercial Bank of China (ICBC) opened a subsidiary in Milan.

However, the main investment carried out by Chinese companies occurred after the 2000 and represent a recent and consolidate growing interest thanks to an unprecedented economic expansion in a such short historical period of time.

With regard to sectoral specialization, the main fields involved in these deals are automotive and household appliances. Both industries in which Italy traditionally developed strong skills, production capabilities and where Chinese private equity houses are dramatically increasing their funding and competencies.

In terms of number of investments, Transport and Logistics is a fundamental sector for foreign investment owing to the geographical position of Italy. Electronics and telecommunication are also interesting industries to invest in differently from the Chinese market where foreign investors are not allowed to take part in sensitive industries like media.

Geographically, Chinese investments are strongly concentrated in the North of Italy [Figure 23] which is considered the wealthiest and most industrially developed part of the country (the “industrial triangle” of Milan, Genoa and Turin is located in the north) with

about 65% employees and 54% of the country businesses. Even though the capital is Rome, the financial and fashion capital is Milan.

	Lombardy	Piedmont	Veneto	Emilia	Lazio	Rest of Italy	Total
White goods	3	1	5	-	-	1	10
Automotive	1	6	-	-	1	1	9
Transport and Logistics	3	-	-	-	1	3	7
Trade services	4	-	-	1	-	-	5
Texties	4	-	-	-	-	-	4
Electronics	5	-	-	-	1	-	6
Telecommunications	1	2	-	-	2	-	5
Metal products	3	1	-	-	-	1	5
Machinery	3	-	-	1	-	-	4
Chemical products	2	-	-	1	-	-	3
Financial services	2	-	-	-	-	-	2
Others	3	-	2	1	1	1	8
Total	34	10	7	4	6	7	68

Figure 23: Sectoral and geographical distribution of Chinese foreign direct investment in Italy
Source: AIDA Database, ICE Database

The Center of Italy record some Chinese investments, in particular the Emilia Region is renowned for some of the world's leading high tech automotive (Maserati, Lamborghini, Ferrari, De Tomaso, etc.) and motorbike manufacturers (Ducati, Agusta, etc.). Moreover Emilia has several private and public laboratories dedicated to intelligent automation as well as boast efficient R&D and production chemistry and pharmaceutical district.

The south of the country, known as Italia Meridionale, show the worst country economical performance and consequently the less attractive areas to invest in. Although the critical issues should be faced (Campania region has the highest unemployment rate in

the entire EU), the Italian government and EU development grants are currently investing heavily in these zones trying to improve infrastructure, green-field sustainability initiatives, solar energy, tourism and real estates.

Returning to the chart, the region of Lombardy hosts 34 investments, 15 in Milan and its metropolitan area. Definitely Lombardy is the main attractive destination where to invest in Italy which hosts half of the whole investments carried out in the country. Milan, as the Italian financial hub, is characterized by numerous investments in the financial sector and in the management consulting industry in order to assist Chinese companies willing to make business in Italy.

The second most attractive region is Piedmont with ten Chinese foreign direct investments undertaken. The latter are owed to its strategic cluster specialized in the automotive sector.

Other regions listed in the chart are involved in different sectors o specialization: Veneto in white goods, Emilia Romagna in machinery as well as automotive. The regions included under the heading Rest of Italy comprehend Campania and Liguria (Transport and Logistics), Marche, Tuscany and Basilicata which are mentioned for Chinese investment in Food & Tobacco and Plastics sectors. Finally, under the heading Others activities, are included industries like Toys, Jewellery and Bicycles.

More in detail, is possible to obtain further insights about the disaggregation of investments by main activity. This analysis is carried out in the span of time between 1986 and 2009. At the beginning, Chinese companies were focused on establishing Sales and Marketing offices as it happened in the other European countries. Instead, recently there has been an increase in activities as manufacturing (since 2000) and R&D (since 2006).

This is the proof that traditional trade related investments are moving to advance services which include techniques aimed to enter in new markets and the acquisition of new brands.

4.2.4 Main M&A operations by Chinese firms in Italy

Over time, the Chinese presence in Italy have experienced a gradual evolution in its entry mode. While the first waves of investments were aimed to open representative offices in order to support small scale green-field investments and thus in different activities like R&D and marketing, from 2000 the investment technique have been changed. In fact more attention is paid in M&As where, behind these operations, are actively involved private equity funds. Some noteworthy acquisitions are listed in the graph below [Figure 24].

Year	Target	Acquirer	Sector	Size (employees)	Stake (%)
2001	Meneghetti	Haier	White goods	100	100
2004	Wilson	Wenzhou Hazan	Textiles	n.a.	90
2005	Benelli	Quianjiang	Automotive	100	100
2005	Bburago	Maisto	Automotive	n.a.	n.a.
2006	Elios	Feidiao Electrics	White goods	54	n.a.
2007	HPM Europe Spa	Hunan Sunward Intelligent Machinery	Machinery	6	51
2007	Omas Srl	Xinyu Hengdeli Holdings	Luxury goods	48	90
2007	Gruppo Tacchini	Hembly	Textiles		100
2008	Cifa	Changsha Zoomlion	Machinery	70	60
2009	Elba	Haier	White goods	150	20
2011	Ferretti	Shandong Heavy Industry	Luxury goods	2300	75
2012	De Tomaso	Hotjork Investment	Automotive	1000	80

Figure 24: Main M&A operations by Chinese firms in Italy
Source: AIDA Database, ICE Database

Among them, the recent takeover of Cifa, specialized in the production of machinery for the building sector, by Changsha Zoomlion (60% stake) is considered the largest acquisition in Italy and the second in Europe carried out by Chinese companies, with an estimated disbursement of 500 million Euro. The remaining 40% stake is owned by several

private equity shareholders: the Italian funds Magenta and Mandarin Capital Partners, the Chinese firm Hony Capital and Goldman Sachs Private Equity Group.

This pool of private equity investors are the main source in order to give Zoomlion (listed in the Shenzhen Stock Exchange) a foothold in foreign markets and boost its overseas sales thanks to Cifa's international brands, technologies, global sales and distribution network.

Another relevant acquisition regard the Italian luxury yachts builder Ferretti Group by the Chinese state owned company Shandong Heavy Industries (75% stake) for 374 million Euro. The remaining 25% is shared out between Royal Bank of Scotland and two private equity funds: Candover and Permira. Thanks to fresh capital provided by the Chinese company and the Scottish bank in one hand, and management as well as technical skills by private equity houses on the other hand, Ferretti Yachts is able to be saved from a potential bailout. Moreover, a new strategic plan is designed for re-launching the target company through the expansion in the Chinese market and Asian countries. In fact a showroom in Shanghai opened in 2010 and, according to the management declaration (August 2012) the idea for establishing in the near future a supply chain is still being evaluated.

4.3 OPPORTUNITIES FOR ITALIAN INVESTORS IN CHINA

4.3.1 Where is China next booming market for Italian investors?

Till recently, most of China's wealth has been concentrated in the cities on the east coast, namely Shanghai, Beijing, Guangzhou and Shenzhen (also defined "Tier 1" cities, for those more familiar with the Chinese classification ways).

However, in the last few years things have been changing rapidly due to the synergic action of many factors:

- Government intervention to increase life conditions of the central and inner Provinces;
- The increasing cost of living, property, offices, labor, etc. that is progressively pushing companies outside the costal megacities, starting from the primary sector;
- The growing purchasing power of consumer living in what China calls "Tier 2", "Tier 3", and "Tier 4" cities;
- And the combined effect that these factors generate on the progressive upgrading of the whole infrastructure, industrial, residential and commercial value chain to serve the needs of a relatively more affluent population.

Besides, the market in the big cities on the east coast is rapidly getting saturated and reserves opportunities of business just for multinationals due to the expensive costs.

According to today's classification, the Tier 1 comprises the above mentioned four megacities, Tier 2 includes about 85 provincial capitals and cities with high population and economic importance, while there are approximately 220 county-level cities in Tiers 3 and around 400 capitals of county towns in Tier 4.

While most foreign companies offering consumer goods, as well as luxury products, still choose to target the affluent customer living in Tier 1 cities, often the emerging opportunity of the lower tiers remains unexploited.

This is China next booming market for Italian companies thanks to the already mentioned “Go West policy” undertaken and supported by the Chinese government through economical incentives.

A territory where the new Chinese consumer is taking shape, still geographically dispersed and culturally diverse. It is the place where international brands still little know and where the big challenge is to understand how to create a bond, a communication line with these new consumers and also leveraging emotional and cultural connections.

Especially for the luxury goods sector China represent the largest mass market of the world, but also about affluent and wealthy consumer with their unique set of criteria, tastes, and preferences.

Moreover, the proportion of affluent households in the top 8 cities is expected to decline sharply by 2012, while the proportion will rise by 4 times in the smaller cities as a result of the economic boom which is taking place in the inland regions.

Understanding this new China economy needs, together with a prompt action to make the products available in Tiers 3 and Tiers 4 cities faster than competitors, is the next China opportunity for foreign investors.

The successful strategy to quickly identify how to aggress the Tier 3 and Tier 4 opportunity might figure it out the key areas which shall present a balance between market potential and barriers to entry the market, preliminary profiling of local Chinese companies clusters to target, identification of key success factors to operate in specific areas selected where the Italian companies might obtain competitive advantages.

Another relevant aspect, especially for the Italian companies specialized in the manufacturer and industrial sector, regard the research and selection of suppliers. Sourcing in China is a practice more and more used by foreign investors as it is described below.

In a global context where the developing countries continue to expand their competitiveness on products with higher added value, which is added an economic situation that recommends increased attention to debt and free cash flows, more European manufacturing companies are questioning their make or buy strategies looking for more flexibility, containment of fixed costs and refocusing on their core business.

For these companies, China is the right choice where is suitable supplies with quality levels comparable to those in Europe, products, components, semi-finished products, machinery sold at affordable prices that allow to remain competitive.

However, moving by themselves for buying in China could be very expensive: Chinese standards and local regulations are not immediately simple to understand, monitor compliance of agreed conditions (quality, quantity, delivery, payment) is often complex; remote manage Chinese suppliers is not trivial (distance, language, culture, etc). In addition, production is gradually shifting to the inland Provinces, so on one hand labor is cheaper, on the other get information and evaluate the reliability of the interlocutors is much more difficult: everything involves the risk of opportunistic behavior.

Even though the considerable difficult of expanding a corporate activity in the inland regions due to the remoteness from the major industrial and commercial centers of the country, it worth to mention a successful foreign direct investment carried out by an Italian company.

This is the case of Italcementi Group, a multinational operating in the production of building materials, in particular cement, construction aggregate and ready-mix concrete; more in detail, is the 5th largest cement producer worldwide and the most influence in the Mediterranean area.

Italcementi Group began its adventure in China in 2007 when established its headquarter in the Shaanxi province. Then, it acquired the 100% of Fuping Cement from China's Zhejiang Guangyu Group. Moreover, in 2010 the company strengthen its presence through the acquisition of the 35% stake in Shifeng Cement.

Afterwards, on May 2012 Italcementi Group became one of the main shareholders and strategic partner of West China's Cement. The agreement foresaw the sale to West China Cement of all its participation acquired in the previous years, after which Italcementi Group owned approximately 6,25% stake in West China Cement as well as reserving one member on the Board of Directors within the Chinese group.

Thanks to this transaction Italcementi Group reinforce its presence in China, the world's largest building material market, and though the signed partnership with one of the principal private sector operators in the country new attractive strategy prospective are

targeting other high-growth regions in Western China. Moreover, Italcementi and West China Cement, in order to become more competitive, are developing a wider range of innovative building materials solutions and products as well as reinforcing the local sourcing activities for components and machinery.

4.3.2 Cross cultural differences: the case of guanxi

One of the hardest challenges the Italian investors have to face to get into China regard the cross cultural differences: at a first sight they might be considered as a tricky obstacle to overcome but, if understood and exploited in the right way, result a font of competitive advantage. Among them, the most influence and concrete factor widespread in the whole Chinese culture to keep under consideration for foreign investors is the concept of guanxi, which roots are even traced back to the traditional Confucianism culture.

In the Chinese culture the word guanxi refers to the idea of establishing a connection in the purpose of securing itself favors. The aim is to create an intense, pervasive relational network which Chinese people and other entities develop with a particular carefulness. Guanxi means implicit reciprocal obligations, guarantees, deals as well as code of conducts necessary for Chinese dispositions toward long lasting social and business relationship. This term should be considered more than a simply friendship or interpersonal relations as it comprises mutual commitment that respond to assistance requests.

According to Luo studies (2007), the extraordinarily of guanxi lies in it omnipresence and its key role in daily life then creating and maintaining a guanxi network is strictly suggested for entrepreneurs, managers, officials and even college students (Luo,2007). Within Chinese society guanxi is one of the major dynamics, being a omnipresent part of the Chinese business world since ages and connects millions of Chinese companies into a business and social network. Moreover this behavior is broadly identified as a key business determinant of companies performance, as it represents a fundamental resource to survive in both the macro-economy and micro-business. Every Chinese firms, from the smallest to the largest, from the local to the foreigners, have to

face guanxi dynamics an there is no way to survive without having an extensive guanxi network (Luo, 2007).

The concept of guanxi for Western investors is usually considered as a dishonest, unethical, repeatedly secret business practices, assuring advantaged treatments to entities belonging to the identical guanxi network (Standifird and Marshall, 2000). Even Fan Gang (2002), one of the most well-known Chinese economist, describes industry guanxi as a gray area inevitably associated with favoritism, nepotism, unfair competition and fraud.

However, as it underlined by Lovett (1999) consider Guanxi a system that does not respect ethics just because it is not based on western universalistic principles is an error.

Additional to the uncertain policy environments, companies moving to China need to be aware of and deal with a unfamiliar Chinese business culture (Tian, 2007).

This is probably the main cross cultural difference the Western private equity houses, or in a broader exception any other investor, have to face in order to make successful business in China.

Nevertheless, over time and thanks to globalization, a gradual shift from personal trust to system trust could happen since a legal framework is increasingly developing in China. Several young Chinese managers have already accepted Western standards of professionalism and the idea that system trust is superior, as espoused by powerful multinationals but young people, in particular the ones studying abroad, still represent the minority of Chinese population.

Consequently considering a partnership between Western and Chinese entities might be considered a correct choice for mixing know-how and managerial skills with an extended network of contacts as it already took place with domestic funds managed by western private equity entities.

The opportunity to rely on the guanxi network of the Chinese partner represents a competitive advantage for companies expanding into China and, according to Standifird and Marshall (2000), guanxi in Chinese society is distinctive as it has a very important role in daily business activities in China.

For foreign investors drawing from local partners guanxi network is definitely preferred to overwhelm entry barriers when undertaking international joint ventures in

China, even if this restricts the choice of possible local partners. As a result foreign firms seek also for local partners which do not directly contribute to accomplish the goal, but rather possess a guanxi with important government agencies dealing with the formation of this kind of alliances.

Trying to show off key intention of guanxi reserve more chance to receiving governmental and institutional support. Thereby, it is useful to have a Chinese partner owning well-built guanxi with government and further institutions. Moreover according to Tsang (1998), which considers guanxi as a font of competitive advantage, conducting a business in a unknown business environment is risky therefore it is necessary to seek for the support of local firms' guanxi network to implement the aimed business strategies (Rahman, 2008).

4.3.3 Different entry mode to get into China

There are different entry mode used by Italian companies to expand their business in China. Each entry mode reserve different opportunities as well as different challenges.

Thereby is necessary to identify the sector where the company will to establish its activity (light industry heavy industry, services, trading, etc.), the financial commitment desired to invest in, the control grade and many other variables to take under consideration [Figure 25]. Furthermore, the entry mode is strictly linked with sector in which the company is involved.

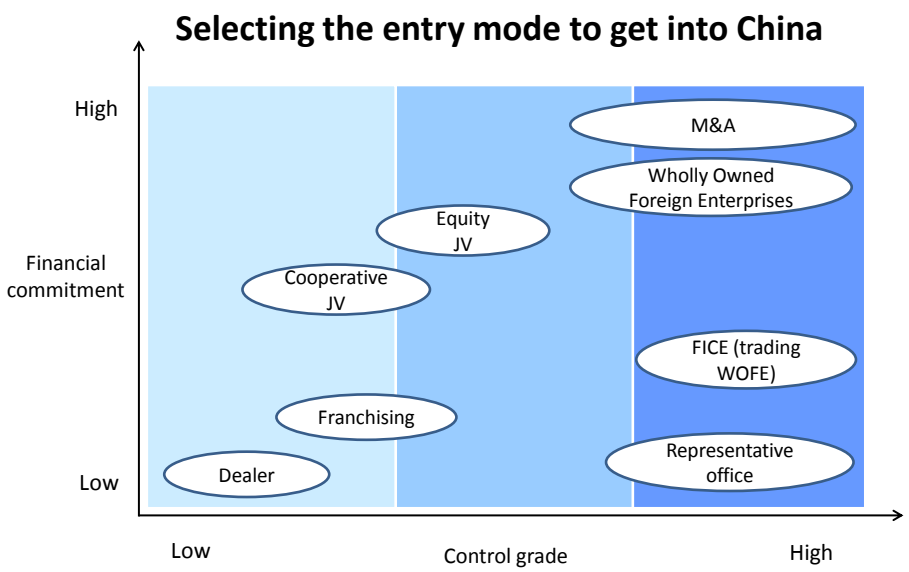

Figure 25: Selecting the entry model to get into China
Source: Elaboration of Data collected by JESA Investment & Management Co. Ltd

Among the different entry typologies, the Wholly Owned Foreign Enterprises (WOFE) represent, in 2010, the preferred way with over the 80% (in 2005 were the 75%) of the whole Italian foreign direct investments in the mainland of China. In a broader exception, this investment vehicle grant a great control over the business venture in China and overwhelm numerous issues that might result with a potential Equity or Cooperative International Joint Venture. The following also include profit not fully maximized, lack of

foreign firm's intellectual property rights (IPR), greater cultural differences to solve, the possibility that the joint venture partners set up a completion against the foreign firm, etc. However, WOFEs need powerful personal relationships, known as guanxi as discussed in the previous paragraph, in order to conduct profitable business in China.

A great example of JV failure, due to communication problems between the two counterparts, regard the partnership involving the biggest Italian automobile manufacturer FIAT and the state-owned company Nanjing. The low-context culture of FIAT did not respect the Chinese culture, with its incessantly pushing Nanjing for results and complaining publicly about the lack of commitment by Nanjing. Italy indeed belongs to an opposite culture, based on explicit communication, giving value to oral ability, reasoning and logic which is the total contrary of Chinese. This divergence indeed brought to frictions between partners and eventually to the dissolution of the partnership.

Instead, a successful business case regard the International Joint Venture between Volkswagen Group China and Shanghai Automotive Industry Corporation (SAIC) which is named Shanghai VW Automotive Co. Ltd [Figure 26].

Calendar year	Total sales
2000	220.000
2001	242.000
2002	301.000
2003	396.000
2004	355.000
2005	287.000
2006	352.000
2007	413.000
2008	501.000
2009	708.000
2010	1.000.000
2011	1.160.000

Figure 26: Sales of Shanghai Volkswagen vehicles in China
Source: Elaboration of Data collected in Shanghai Volkswagen website

This alliance, founded in 1984 with a fixed term venture for 45 years (until 2030), represent the most successful international joint venture based in China. In fact, in 2011 Shanghai Volkswagen sold 1,16 billion cars under the brand Volkswagen and Skoda. The vehicles produced in the Chinese plants are mainly purchased by the emerging business elite, taxi drivers and governmental institutions. In 2006 Shanghai Volkswagen became the leading car maker in China with a share of 20,22%; in 2008 Volkswagen sold even more vehicles in the Chinese market than on its home market in Germany. The successful drivers that make Shanghai Volkswagen profitable are strictly linked to a good reputation by being one of the cheapest German car makers which are a synonym of efficiency, heavy investment in R&D, the production of a wide range of vehicles belonging to different segments, a lean and efficient supply chain. However, Shanghai Volkswagen (differently from Fiat-Nanjing JV) was able to deeply understand the Chinese needs and offer even newer solutions for a dynamic and demanding domestic market.

As a result of the low interest of developing International Joint Ventures, the latter represent 17% of the whole entry modes becoming, over time, less and less attractive for Italian investors. Moreover, in 2005 the Equity JV covered the 25% and the Cooperative JV 2%; in 2010 16% and 1%, respectively.

However, the raise of Wholly Owned Foreign Enterprises became more and more concrete since the revision of the People's Republic of China Company Law Reform (2005) that approved the set up of limited liability companies, except for investing in sensitive industries such as defense and media, which are off limits to foreign investors.

From a sectoral prospective, the Italian investments are mainly concentrated in the secondary industry (especially electronic, IT and appliance, automotive, machinery, garment and footwear) with a share of 62%, consulting and business assistance & Finance in 31% of the cases and 7% for trading services. In brief, the widespread of WOFEs particularly attract Italian companies, as well as private equity investors, in the light and heavy industries both in the inland and coastal areas of China. Consulting, legal and business advisor firms are established through WOFEs and, for the most cases, representative offices based in the megalopolis like Shanghai, Beijing, Guangzhou,

Shenzhen and rarely in the inland regions because the company headquarters are usually based in the most affluent and wealthy areas in order to extend their network of contacts.

Regarding the trading services, the Italian companies are mainly focused on apparel, garment, food and beverage services. In order to grant a sturdy support for selling their products in China, the investors prefer to keep in contact with a renown and qualified dealer or to establish franchised businesses.

4.3.4 The Italian experience in Suzhou

Suzhou is one of the major cities located in the Jangsu province in Eastern China, approximately 80 km far from Shanghai municipality. Suzhou is a prefecture-level city located in Tier 2 with a population of over 4 million, becoming more than 10 million in the administrative area. Notwithstanding this city is geographically and culturally really far from Italy, it has some similarities insomuch is even named "Venice of the East" due to the presence of canals navigated by boats.

Since the early 1990s, Suzhou experienced a relevant growth, never occurred before, thanks to the economic collaboration project signed between Chinese and Singapore government. Thanks to this deal, Suzhou established two different business areas: the Suzhou Industrial park and Suzhou Hi-Tech Industrial Development Zone both covering 288 km^2.

In this area the Italian presence is considerable in terms of investments as well as in terms of number due to the favorable Chinese government decisions, as part of the Go West policy", to attract foreign companies. More in detail, the main factors driving foreign direct investments in Suzhou are the following:

- the entry into force, since 2005, of a three-year tax exemption program for companies willing to establish their production plant;
- offices located in both industrial parks for guarantee free paper works allowing newcomers not to pay any lawyers and consultants to set up a company or a subsidiary;

- lower cost to establish production plants comparing to the Chinese megalopolis, especially for companies who need extended areas;
- competitive infrastructures, transports, logistics network and customs;
- the companies operating in the machinery and metallurgic sectors, which comprehend the most Italian companies, can rely to an extensive network of qualified suppliers;
- Suzhou is a livable city for Western investors and is well linked with Shanghai.

Nowadays, the Italian business community in Suzhou account 159 companies which invest nearly 1 billion Euro [Figure 27], of which 659 million Euro correspond to direct investments, 11000 employees and production plants extended for over 600000 m^2.

In 2009, even though the financial and economical crisis in Italy reached a pick, the export from Suzhou to Italy exceeded 238 million Euro and contributed to the growth of the domestic Gross Domestic Product, which stood 78 billion Euro.

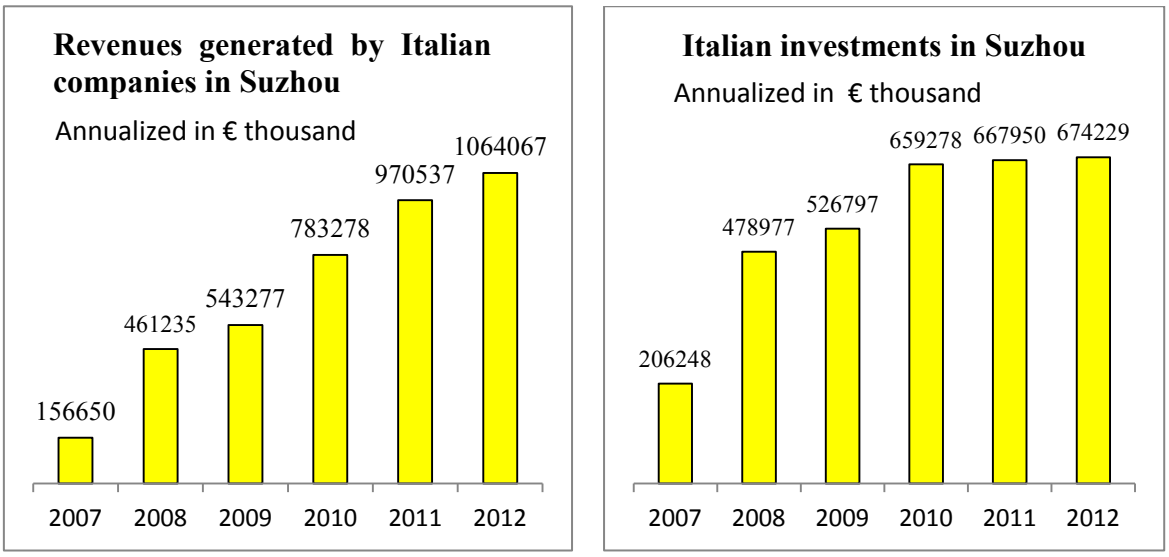

Figure 27: Financial data estimate regarding the Italian presence in Suzhou
Source: Elaboration of Data collected by Sole 24 Ore

The most significant Italian companies establishing their Chinese headquarter in Suzhou as Wholly Foreign Owned Enterprises, just to name a few, are Carel Electronic Co

Ltd (home appliances), Bonetti Level Gauges & Valves Co Ltd (pressure valves), Omet Mechanical Co Ltd (printing and tissue converting machineries), Zamperla Amusement Rides Co Ltd (manufacturing), etc.

In order to support the Italian companies based in Suzhou as well as the newcomers exist an Italian institution named Chamber of Commerce Italy-China (CCIC) that, through the Suzhou Working Group, assist them not to commit strategy mistakes.

In conclusion, the industrial area of Suzhou represent a strategic location to invest in due to the Government incentives to set up new business and the presence of the Italian cluster of companies strictly related each others. In this way, newcomers might rely to this consolidated union and begin to extend their network of contacts enabling to get in touch with well-known institutions in the purpose of granting itself favors. Thus actions, are in a broader exception amenable to the sphere of guanxi.

4.4 References

AIFI (1998), *Quotarsi in borsa,* Il Sole 24 Ore, Milano.

AIFI (2004), *100 domande e 100 risposte sul capitale di rischio per lo sviluppo, Pubblicazione interna*, Milano.

AIFI (2004), *Private equity e corporate governance delle imprese*, Milano.

Akdogan H. (1995), *The integration of International Capital Markets*, Edward Elgar Publishing, Aldershot.

Amighini A. (2008), "China and India in the international fragmentation of the global auto industry: A comparative analysis of recent developments, Working Paper" 10, *Dipartimento di Scienze Economiche e Metodi Quantitativi, Novara: Università del Piemonte Orientale*.

Amighini A. and Chiarlone, S. (2005), "Rischi dell'integrazione commerciale cinese per il modello di specializzazione internazionale dell'Italia", *Rivista di Politica Economica*, 63-86.

A. T. Kearney (2008), *Indovina chi viene a cena? Imprese russe, Indiane e Cinesi in Italia*, A. T. Kearney Publications, Milan.

Barclays Capital (1998), *The Barclays Capital guide to private equity in Asia*, Asia Law & Practice Publication, Hong Kong.

Bergs S. , Duncan, J. and Friedman P. (1982), *Joint Ventures strategies and corporate innovation*. Cambridge, MA: Oelgeschlager.

Bertinetti G.S. (2011), *Corso di strategie d'investimento*, Mc Graw Hill, New York.

Bonaglia F., Goldstein A. and Mathews J. (2007), "Accelerated Internationalization by Emerging Multinationals: the Case of White Goods Sector", *Munich Personal RePEc Archive Paper,* 1485.

Bracchi G. (2011), *Private equity ed economia italiana*, AIFI, Milano.

Buckley P. and Casson C. (1988), *The theories of cooperation in international business*. *Cooperative strategies in international business*, Lexington Books (Maryland).

Buckley P.J., Clegg J., Cross A.R., Liu X., Voss H. and Zheng P. (2007), "The Determinants of Chinese Outward Foreign Direct Investment", *Journal of International Business Studies*, 38: 499- 518.

Bunder J., Buxton M., Bass P., Partridge B. (2011), Private equity in China: Thinking global, acting global, *Ernst & Young*.

Camp. J.J.(2002), *Venture Capital Due Diligence: A Guide to Making Smart Investment Choices and Increasing Your Portfolio Returns*, Wiley Finance, Hoboken (New Jersey).

Campos N.(2000), "Context is everything: measuring institutional change in transition economies", *Policy research working paper series*, 2269, The World Bank.

Cappelletto R. (2004), *Elementi di finanza aziendale*, Giappichelli Editore, Torino.

Caselli S. (2010), *Private equity and venture capital in Europe: markets, techniques, and deals*, Academic Press/ Elsevier, Academic Press, Waltham (Massachusetts).

CESFIM (May 2012), "Italia in crisi edilizia", *CESFIM*.

CESFIM (June 2012), "Case invendute e prezzi a picco: addio al mattone come bene rifugio", *CESFIM*.

Chan J. (2008), *Venture Capital & Private Equity in* China, Lexis Nexis, Dayton.

Child J. (1994), *Managing in China during the age of reform*. Cambridge, England: Cambridge University press.

Cimino S. (2003), *Come e perchè investire in Private Equity*, Amministrazione & Finanza ORO, n°6, Ipsoa Editore, Milano.

Committeri M. (March 2004), *Investire in Italia? Risultati di una recente indagine empirica*. Temi di Discussione del Servizio Studi Banca d'Italia No. 491, Milano.

Cooke D. J.(2008), *Private equity: law and practice*, 4th ed., Sweet & Maxwell, London.

Cornelius P. (2011), *International investments in private equity: asset allocation, markets, and industry structure*, Academic Press, Waltham (Massachusetts).

Cumming D. (2009), *Venture capital and private equity contracting: an international prospective*, Academic Press, Waltham (Massachusetts).

Cumming D. (2010), *Private equity: fund types, risks and returns, and regulation* , Wiley Finance (Kolb Series), Hoboken (New Jersey).

Davidoff S. (2009), *Gods of war: shotgun takeovers, government by deal, and the private equity implosion*, Wiley Finance, Hoboken (New Jersey).

De Nova G. (2009), *Italian Civil Code*, Zanichelli Editore, Bologna.

Deutsche Börse Group (2011), European investors' exposure to Chinese private equity, an insider prospective, *Deutsche Börse Group*.

Dresner S. (2009), *The issuer's guide to PIPEs: new markets, deal structure, and global opportunities for private* investments *in public equity*, Bloomberg Press, New York.

EVCA (2002), "*Entrepreneurs views on various methods of realizing the value of their businesses"*, EVCA.

Feltenstein A. and Nsouli S. (2001), "*Big Bang" Versus gradualism in Economic reforms: An Intertemporal Analysis with an Application to China*. International Monetary Fund. Available through: EBSCO [Accessed February 2010].

Foreign Investment in China (1996), *China Foreign-Invested Enterprises Association, Issue*, 4-6.

Fraser-Sampson G. (2007), *Private equity as an asset class*, 2nd ed., Wiley Finance, Hoboken (New Jersey).

Gervasoni A (2000), I fondi di investimento, *Il Sole 24 Ore*, Milano.

Gervasoni A., Bechi A. (2007), *I fondi chiusi di private equità nell'economia italiana: aspetti economici e giuridici*, Il Mulino, Bologna.

Gervasoni A., Sattin F. (2008), *Private equity e venture capital: manuale di investimento nel capitale di rischio*, 4° ed, Guerini e Associati Editore, Milano.

Ginsburg T. (2005), International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance, *International Review of Law and Economics*, 25 (1), 107-123.

Gottlieb R. (2010), *The directory of venture capital & private equity firms: domestic & international*, Grey House Publishers, New York.

Greve T. (1987), *How to do leveraged buyouts*, Business Publications, San Diego (California).

Hale C. (2010), *Private equity: a transactional analysis*, 2nd ed., Globe Business Publishing, London.

Hay F., Milelli, C. and Shi Y. (2009), *Chinese Firms enter Europe: Some Empirical Evidence. Sector Reforms and the International Integration of China*, London: Routledge.

Hinton W. (1990), *Great reversal: The privatization of China,1978-1989*. New York: New York University Press.

Harringan K. (1985), *Strategies for Joint ventures success*. Lexington, MA: Lexington Books (Maryland).

Hobohm D. (2010), *Investors in private equity funds: theory, preferences and performances*, Gabler Verlag, Berlin.

Hopkins B. (2009), *Cultural Differences and Improving Performance*. Gower Publishing Limited, England (Surrey).

Jefferson G. and Xu W. (1991), "The impact of reform on socialist enterprises in transition: Structure, conduct and performance in Chinese industry", *Journal of comparative economics*, 15: 45-64.

Jenkinson T. (2005), *The development and performance of European private equity*, Saïd Business School, Oxford University and CEPR.

Johnson J. and Tellis G.(2008), "Drivers of success for market entry into China and India", *Journal.*

Jowett P., Jowett F. (2011), *Private equity: the German experience*, Palgrave Macmillan, Basingstoke.

Klier D.O. (2009), *Managing diversified portfolios: what multi-business firms can learn from private equity*, Physica – Verlag, Berlin.

KPMG (2006), *Italy, a place to invest in*, *1986-2006: 20 years of AIFI, Private equity successful excellent performances*, KPMG Advisory.

KPMG (2006), *2006: A successful year!, Italian Private equity and Venture Capital market: 2006 performances*, KPMG Advisory.

KPMG (2007), *2007: Consolidating growth!, Italian Private equity and Venture Capital market: 2007 performances*, KPMG Advisory.

KPMG Advisory, K Studio Associati (2008), Alcune domande e risposte sul come e perchè investire in fondi di Private Equity, , KPMG Advisory, K Studio Associati.

KPMG (2008), *2008: A bumpy ride!, Italian Private equity and Venture Capital market: 2008 performances* , KPMG Advisory.

KPMG (2009), *2009: Into the storm!, Italian Private equity and Venture Capital market: 2009 performances* , KPMG Advisory.

KPMG (2010), *2010: A long dawn!, Italian Private equity and Venture Capital market: 2010 performances* , KPMG Advisory.

KPMG (2011), *2011:Back to returns!, Italian Private equity and Venture Capital market: 2011 performances* , KPMG Advisory.

Kwan Yuk P. (2011), "China: Private equity rides the global storm", *Financial times*.

Lake R. (2000), *Private equity and venture capital: a practical guide for investors and practitioners*, Euromoney Books, London.

Levin J.S., Ginsburg M.D., Donald E.R. (2006), *Structuring venture capital, private equity, and entrepreneurial transactions*, 2nd ed., Aspen Publishers, New York.

Lil J., Lam K. and Moy J. (2005), Ownership reform among state firms in China and its Implications. *Management Decision*, 43: 566-588.

Lil J., Lam,K. and Qian,G. (2001), "Does culture affect behaviour and performance of firms? The case of joint ventures in China", *Journal of International Business Studies*, 32: 115-131.

Li P. P. (2007), "Toward an Integrated Theory of Multinational Evolution: the Evidence of Chinese Multinational Enterprises as Latecomers", *Journal of International Management*, 13: 296- 318.

Lin J. Y., Cai,F. and Li,Z. (1996), "The lesson's of China transition to a market economy", *Cato Journal.*

Lin G.S. (1997), "Study on Sino-foreign investment motives in high-tech joint ventures", *China industrial economy,*5: 11-25.

Loos N. (2006), *Value creation in leveraged buyouts: analysis of factors driving private equity investment performance*, Deutscher Universitäts – Verlag, Berlin.

Luo, Y. (1997), "Partner Selection and venturing success: the case of Joint Ventures with Firms in the People's Republic of China", *Organization Science*, 8: 648-662.

Mariotti S., Mutinelli M. (2006), *Italia Multinazionale 2006*, ICE- Roma.

Mathews J. A. (2006), "Catch-up Strategies and the Latecomer Effect in Industrial Development"*, New Political Economy Journal*, 11.

Mathews, J. A. (2006), "Dragon multinationals: New players in 21st century globalization", *Asia Pacific Journal of Management*, 5–27.

Mathonet P., Meyer T. (2005), *Beyond the J Curve: managing a portfolio of venture capital and private equity funds*, Wiley Finance, Hoboken (New Jersey).

Mathonet P., Meyer T. (2008), *J Curve Exposure: managing a portfolio of venture capital and private equity performances*, Wiley Finance, Hoboken (New Jersey).

MOFCOM (2007), "2006 Statistical Bulletin of China's Outward Foreign Direct Investment", *MOFCOM*.

Müller K. (2008), *Investing in private equity partnerships: the role of monitoring and reporting*, Betriebswirtschaftlicher Verlag Gabler, Berlin.

O'Brien J. (2007), *Private equity, corporate governance and the dynamics of capital market regulation*, Imperial College Press, London.

Obstfeld M., Taylor A. (2005), *Global capital markets: Integration, Crisis, and* Growth, Cambridge University Press, Cambridge.

Pignal S. (April 12th 2012), "Private equity targeting emerging markets", *Financial Times*.

Povaly S. (2007), *Private equity exits: divestment process management for leveraged buyouts*, Springer Verlag, Berlin.

Pricewaterhousecoopers (2006), *The economic impact of Private equity ad Venture Capital in Italy*, Pricewaterhousecoopers.

Pricewaterhousecoopers (2008), *The economic impact of Private equity ad Venture Capital in Italy*, Pricewaterhousecoopers.

Roscigno A., Masih R., Gandhi M. (2010), *Enter the dragon: Private equity opportunities for accessing the Asia growth story*, J.P. Morgan.

Rothschild (2010)," How to Make Successful Private Equity Investments in China and Europe?", *Rothschild of Marketing*, 72: 1-13.

Schwartz D., Rubenstein D. (2010), *The future of finance: how private equity and venture capital will shape the global economy*, Wiley Finance, Hoboken (New Jersey).

Sheng J., Li B., Miao J. (2003), *Investment in China: Opportunities in Private Equity and Venture Capital*, Tsinghua University Press, Beijing.

Shenkar O.(1990), International Joint Ventures' problems in China: risk and remedies. *Long Range Planning,* 23: 82-90.

Sommariva T. (2011), *FIAT- Nanjing Failure in China*. Working Paper. UK, London: EBS, Regents College.

Spigarelli F. (January 2008), "Nuovi Investitori Globali: le Imprese Cinesi in Italia", *University of Macerata Working paper.*

Story J.(2003), *China the race to market*. Harlow, UK: Pearson.

Story J.(2010), *China Uncovered: What You need to know to do business in China*. Harlow, UK: Prentice Hall.

Temple P. (1999), "*Private equity: examining the new conglomerates of European Business"*, Wiley Finance, Hoboken (New Jersey).

The Economist (January 27th 2011), "Private equity: Public exposure", *The Economist*, 14-15.

The Economist (November 25th 2010), "Private equity: Barbarians in love", *The Economist*, 24-26.

The Economist (December 10th 2011), "Private equity, One careful owner? , The Economist", 42-43.

The Economist (November 12th 2011), "Private equity: Fee high so dumb, The Economist", 52-53.

The Economist (June 30th 2011), "Streaks of red, capital and companies from China are sliding into Europe", *The* Economist, 16-18.

The Economist (January 28th 2012), "Private equity: Monsters, Inc?, *The Economist"*, 7-8.

The Economist (January 28th 2012), "Private equity under scrutiny, Bain or blessing?", *The Economist*: 61-62.

The Economist (March 17th 2012), "Foreign investment in Italy: Luxury on the cheap", *The Economist*: 63.

To H., Stoneley R. (2008), *Private equity in China: Market sentiment survey*, KPMG.

Visconti R., Gentili M. (2005), *Come valutare gli intermediari finanziari: Sim, Sgr, fiduciarie, fondi chiusi e Sicav, hedge fund, fondi immobiliari, venture capital e private equity, holding, broker assicurativi, money transfer, securitization*, Bancaria Editrice, Roma.

Wild J.J., Wild K.L. and Han J.C.Y. (2008), *International Business: The challenges of Globalization*, 4th ed. Harlow: Pearson Education.

Williamson A. (2003), *The Chinese Business Puzzle*. Oxford: How to Books.

Wright M., Bruining H. (2008), *Private equity and management buy-outs*, Edward Elgar Publishing, Cheltenham.

Yang J., and Lee H. (2002*), Identifying key factors for successful joint venture in China*. [e-journal] Available through: Emerald.

Yates G. (2010), *A practical guide to private equity transactions*, Cambridge University Press, Cambridge.

Zeira Y. and Shenkar O. (1990), "Interactive and specific parent characteristics: implications for management and human resources in international joint ventures", *Management international Review*, Vol.30, Special Issue, pp 7-22.

Zhang Y. (2007), "R&D Intensity and International Joint Venture Performance in an Emerging Market: Moderating Effects of Market Focus on Ownership Structure", *Journal of International Business Studies*, 38/7.

Zinzius B. (2004), "*Doing Business in the New China"*, 1st ed., Praeger Publisher, Westport (Connecticut).