THE GROWTH OF FAMILY FIRMS:

an Innovative Model based on Public-Private Partnership

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ABSTRACT

The crucial role of Family Firms in supporting the economic development of a territory has stimulated the flourish of a variety of Public Policies, such as tax benefits, special funds, guarantees and expertise development. Nevertheless, in a global economy, given the growing importance of factors such as integration, internationalization and innovation, it is necessary to redesign the public intervention.

This study proposes a new model of intervention suitable for financing the growth of Family Firms and investigates its expected effects. The model is based on a Public-Private Partnership (PPP) capable to enable an enterprise network of Family Firms supported by a special financial vehicle.

Given the positive correlation between Family Firms development and territorial development, the Public Sector can benefit from this new policy to achieve socio-economical goals. This study shows that, as promoter of the initiative, the role of the Public Sector should be to enhance the creation of favorable conditions for the development of the enterprise network, acting as facilitator and integrator of the system. Moreover, it should be responsible for the creation and monitoring of the activities of the financial vehicle in which co-exist private resources brought by Pension Funds and Mezzanine Funds. At the same time, the study supplies the Public Sector with an integrated scorecard in order to measure both socio-economical and financial performances.

A systematic classification of existing Public Policies shows that this model would maximize the benefits of all actors involved.

The dynamism of firms financed by risk capital and the worsening of credit conditions, highlight the need of financing the enterprise network through equity. Nevertheless, Family Firms are resistant to lose control. Considering that the purpose of this study is the growth of Family Firms, this model requires the financing of the firms' network not only through equity but also through a hybrid instrument, the Mezzanine finance. This type of instrument, in contrast with the traditional debt capital, is suitable for financing the expansion projects of Family Firms thanks to its flexibility and long-term orientation. The intervention of private investors in the partnership program is carried out not only through a contribution of financial resources, but also with the provision of expertise which absence could, indeed, undermine the survival of firms.

This innovative form of intervention could be significantly implemented in an area characterized by the intensive presence of Family Firms. The Italian territory represents a potential area of applicability of this new policy because its economic system mostly relies on Small and Family Firms.

Keywords: Family Firms, Growth, Enterprise Network, Public-Private Partnership, Financial Vehicle, Mezzanine Finance

1. CONTEXT

Family Firms (FFs) are a widespread enterprise structure and, according to the European Commission definition[1], are typically characterized by a small or medium size. The FFs are one of the main engines of the economic tissue, in fact, in the European Union, the seventy percent of companies are Family Firms and the ninety-nine percent are Small and Medium Enterprises (SMEs). The main characteristics of the Family Firms are the proprietary structure, which is typically concentrated in the hands of a family, and the system of governance, which is often characterized by management contrasts and interferences between personal and business assets.

Empirical evidence shows that the availability of resources for the financing of the business is a prerequisite for the birth and development of FFs and, therefore, for the enjoyment of the future economic benefits that they generate. Nevertheless, the funding of FFs depends excessively on bank credit which is the major, if not the unique, source of financing. The consequences of an excess use of debt are reflected in an unbalanced financial structure characterized by an extensive use of debt and a very limited use of risk capital. The strategic importance of the optimal capital structure in the financing decisions of business activities derives from the awareness that the lack of adequate funding can threaten the survival of companies in the medium and long term. The crisis of the financial markets and its propagation to the economic system have profoundly affected the small and medium-sized companies, which are facing increasing difficulties in conducting their business in a profitable way. As a result of the crisis and of the more stringent regulations on capitalization ratios and risk coverage, the financial and credit intermediaries are now changing their lending policies; consequently, the FFs encounter more difficulties in accessing the necessary funds for their activity. The main financial constraints of FFs can be described as follows:

- the deterioration of credit conditions;
- the presence of not always qualified management;
- the adoption of unstructured processes;
- the existence of information asymmetries.

One of the priorities for Governments and economists is to identify the strategies and policies best able to support the enterprise system; the aim is to promote adequate funding and limit, as much as possible, the problems of access to credit. In the current turbulent context, both a balanced financial structure and an adequate management expertise are necessary for the survival of FFs. At the state of art, FFs do not have adequate resources to conduct at their best the entrepreneurial activity and, consequently, they face difficulties in improving their competitiveness in a situation where innovation is a driving force in the international context.

[1] Appendix: Table 3.

Innovation and internationalization are joint challenges which have become unavoidable. Innovative firms are the most internationalized and benefit from better performances in terms of growth, productivity and innovation. Therefore, the issues on which Family Firms should concentrate are summarized in the acronym "3Is":

- Innovation, in order to increase the FFs' competitiveness;
- Integration, in order to benefit from the positive externalities generated by the network;
- Internationalization, in order to widen the potential market and deal with a global competition.

2. MAIN OBSTACLES TO THE GROWTH OF FFS

The Family Firms' enterprise structure present both advantages and disadvantages. Some authors have underlined that the family ownership and control are beneficial in mitigating the principal-agent conflicts that affect the firms run by professional managers without any relationship with founding family. Jensen and Meckling (1976) have asserted that there is a misalignment between the interest of managers and those of owners; using the Agency Theory as a basis for developing a model of corporate structure, the authors have defined the agency relationship as "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent" (Jensen and Meckling, 1976, p.308). The authors also define agency costs as the sum of: the monitoring expenditures incurred by the principal, the bonding expenditures incurred by the agent, residual loss.

As far as the Agency Problem is concerned, some authors agree that the separation between ownership and control creates costs that may not exist when the role of ownership and management are overlapped (Chrisman, Chua and Litz, 2004). In contrast with this theory, Fama (1980) has suggested that the separation of ownership and control can be an efficient form of economic organization. Daily and Dollinger (1991) have demonstrated the differences existing between family controlled and non-family controlled firms in terms of firm size, firm age, firm strategy and internal control system. The results of the analysis show that family controlled firms tend to be smaller, to have higher mortality rates and to rely less on formal control system. The absence of separation between management and control could lead to an opportunistic behavior that does not support the interests of the firm. Despite the presence of the family ownership could reduce the monitoring costs, the psychological conflicts within the family - such as sibling rivalry, autocratic behavior and nepotism - could offset the benefits of the reduced monitoring (Kets de Vries, 1993).

The positive aspects of a Family Firm structure are a strong entrepreneurial talent, a sense of loyalty, long-term strategic commitment, pride in family tradition and corporate independence. These benefits are, however, undermined by some negative aspects such as a lack of professionalism, nepotism, rigidity in adapting to new challenges and family feuding. For the purpose of avoiding the loss of control, ownership and financial independence, the proprietorship of the Family Firms often overlooks growth opportunities (Poutziouris, 2001).

As far as the financial structure is concerned, the literature suggests that the level of equity held by a firm's management does influence the firm's efficiency, profitability and capital structure by hindering its value. According Jensen and Warner (1998) the mix of a firm's financial claims could affect the firm's cash flows and therefore its value (Jensen and Warner, 1998).

De Vissecher, Aronoff, and Ward (1995) have noted that funding is one of the challenges that a family business has to face. Many businesses fail because of insufficient capital and liquidity. Ownership transitions can exacerbate these problems because the succeeding generations may not have the same business and financial goals of the original founders. An increasingly competitive market could jeopardize the survival of Family Firms which are not equipped to undertake a strategic repositioning. Moreover, de Visscher et al. (1995) have stated that the emerging internal pressures to finance entrepreneurial renewal could result in selling out of FFs, facing hostile takeovers, struggling to defend market share or even becoming insolvent. Many authors view Family Firms as the backbone of the private economy, as they make a substantial contribution to the national socio-economic and entrepreneurial development (Connolly and Jay, 1996; Neubauer and Lank, 1998; Romano, Tanewski and Smyrnios, 2000).

Family Firms' Advantages
Family ownership and control are beneficial in mitigating the principal-agent conflicts (McConaughy, D.L., Matthews, C.H. and Fialko, A.S., 2011)
The separation between ownership and control creates costs that may not exist when the role of ownership and management are overlapped (Chrisman, Chua and Litz, 2004)
Family Firms are characterized by strong entrepreneurial talent, sense of loyalty, long-term strategic commitment, pride in family tradition and corporate independence (Poutziouris, 2001)
Family Firms' Disadvantages
The separation of ownership and control can be an efficient form of economic organization (Fama, 1980)
Psychological conflicts within the family - such as sibling rivalry, autocratic behavior, and nepotism - could offset the benefits of the reduced monitoring (Kets de Vries, 1993)
For the purpose of avoiding the loss of control, ownership and financial independence, the proprietorship of the Family Firms often overlooks growth opportunities (Poutziouris, 2001)
An increasingly competitive market could jeopardize the survival of Family Firms which are not equipped to undertake a strategic repositioning (de Visscher, Aronoff and Ward, 1995)

Table 1 - Main Family Firms' Advantages and Disadvantages

3. Classification of the Conventional Public Policies

The Public Sector's institutional aim is to enhance the socio-economic development of a territory by enabling the growth of the economic fabric. The crucial role of Family Firms in supporting the economic tissue deeply clashes with the shortfall of resources to finance their activities; these constraints have stimulated the flourish of a variety of Public Policies to enhance the FFs' growth. These policies can be clustered in three main categories: direct monetary intervention, indirect monetary intervention and non-monetary intervention. The first category of policies includes all the forms of intervention in which the Public Sector invests monetary resources and, therefore, increases its expenditures. The direct monetary intervention is often characterized by a partnership between the Public and Private Sector; the intervention of the Public Sector should complement, rather than substitute, the private financial resources and expertise. The main forms of the direct monetary intervention are:

- Investment Funds: risk capital funds in which the Public Sector may co-invest with private investors, usually in a risk-profit sharing logic. Sometimes, however, the Public Sector may accept less advantageous terms than private investors, for example a higher risk profile or lower priority in the distribution of returns on investment (different return profile);
- Financial Instruments: a set of tools that the Public Sector can make available to private investors to boost capital inflows. Among these tools, the semi-equity and mezzanine financing are innovative financial instruments;
- Grants for Funds: grants whose aim is to cover administrative costs and operating costs, they may appear to be potentially less effective in stimulating private resources;
- Guarantees: address to risk capital funds or investors and can be issued on borrowings or in order to cover part of any investment loss.

The tax incentive is, instead, clustered as an indirect monetary form of intervention which does not increase the Public expenditures but rather decrements the tax revenues by offering tax benefits to specific categories of firms or investors and thus enabling the growth of firms.

Finally the Public Sector can intervene on a territory bringing non-monetary sustain, such as:

- Regulatory intervention;
- Supply of services to firms in order to overcome the information asymmetry, the knowledge and management gap and to improve the entrepreneurial culture;
- Enhancement of new entrepreneurial initiatives and university spin-offs.

Each type of intervention is characterized by positive and negative aspects that is necessary to consider for the definition of a Public strategy. First of all, the direct monetary intervention could lead to a rapid growth of the resources available to a firm by intervening on the capital structure or by facilitating the access to credit; these policies enable firms to address short-term imbalances as well as planning long-term investments. As far as the undercapitalized firms are concerned, the supply of risk capital rather than debt capital can promote innovation thanks to its long term nature. Debt capital, indeed, is not the best way to support the innovative activity of enterprises that often, given the inherent riskiness of their activity, are 'suffocated' by the repayment of capital and interest. The direct monetary forms of intervention have an impact on public expenditures and, if not well addressed, could endanger the Public finance situation.

Moreover, not well targeted subsidies could cause the crowding out of the Private Sector and thus might create a distortion of the market. Finally, the monetary intervention of the Public Sector could create conflicts between Private and Public governance and management of the resources.

As far as the indirect monetary intervention is concerned, the tax benefits could favor the growth of firms by diminishing the tax burden of enterprises or investors without creating conflicts between Public and Private resources. Nevertheless, also this policy has a cost for the Public Sector which is expressed in the decrement of the tax revenues; this decrement could be sustainable only if it leads to an additionality effect in a way that benefits exceed the reduction of revenues.

The non-monetary intervention of the Public Sector has a limited impact on the Public budget. The Public Sector can have a regulatory role which would enable a better market efficiency. Nevertheless, the cost of this policy is a higher level of bureaucracy from which descends a higher level of fixed costs of compliance. This policy could endanger the smaller firms which do not have the financial capacity to face an increase of fixed costs; therefore, an increase of regulation should be valued considering the relative increment of bureaucracy. The Public Sector could intervene also through the supply of expertise and vocational training; this form of intervention aims to fill the managerial gap and enhance the entrepreneurial culture. Nevertheless, this kind of policy has two main issues:

- The Public Sector pursues primarily socio-economic objectives and only secondary financial ones. This may create conflicts between the Private and Public management;
- The Public Sector may not have the specialized expertise needed by the firms.

The management, therefore, is usually entrusted to experienced and qualified individuals. On the other hand, however, it is important that the Public Sector takes an active role in the monitoring and control. The Table below summarizes the '*pros and conts*' of each type of intervention.

Type of Intervention	Positive Aspects	Negative Aspects
Direct Monetary Intervention	Rapid growth of the financial resources of a company	Increase of Public expenditures Possible crowding out of Private Sector if the intervention is not well targeted Conflicts between Public and Private Sector
Indirect Monetary Intervention	Absence of conflicts between Public and Private Sector	Decrement of the tax revenues Possible distortion of the market
Non-Monetary Intervention	Limited impact on the Public budget	Bureaucracy Public Sector not always have the required expertise Conflicts between Public and Private Sector

Table 2- Classification of existing Public Policies

In a period of substantial economic crisis the Public Sector faces a shortage of resources which is in contrast with the greater financial needs of the economic fabric. The current economic situation is characterized by financial imbalances of firms as well as by the financial constraints of the Public Sector. In this context, the Public Sector should enhance the private and institutional investors through new forms of intervention. One of the priority is, therefore, to create an economic tissue able to attract the private investors and thus, minimizing the public expenditures.

4. INNOVATIVE MODEL BASED ON A PUBLIC PRIVATE PARTNERSHIP

4.1 PUBLIC PRIVATE PARTNERSHIP

Small and Medium Enterprises and especially the small and medium Family Firms encounter many difficulties in obtaining the resources for financing their activities; this problem is due to, among others, the deterioration of conditions for granting the credit, the presence of management that is not always qualified, the adoption of unstructured processes and the existence of information asymmetries that hinder the assessment of the firms by potential lenders.

The increasingly debated topic of the shortfall of resources to finance the business activities, has triggered a series of interventions of the Public Sector in order to encourage investors to provide capital to support the firms' activities and, in particular, the innovative firms' business. Governments and local institutions, being aware of the importance of the Family Firms as well as of the shortfall of private resources, can intervene directly or indirectly in the financing of the SMEs that play a central role in the local economic development. The Public Sector has to define instruments to enhance their growth and to stimulate the Private Sector intervention in terms of financial resources and expertise; this would facilitate the overcoming of some of the asymmetries and imperfections that hinder the gathering of funds. The programs of public private partnership require an active involvement of the Public Sector that should contribute to the consolidation and development of small and medium size enterprises.

Currently, there are a variety of programs that involve the Public and the Private Sector at different stages and with different roles; these innovative forms of intervention are termed in literature with the acronym of PPI: Public Private Initiatives. Lerner (2002) has asserted that even if the structure of these programs may differ, they all rely on two shared assumptions: the Private Sector is not able to provide all the capital which is necessary to finance innovative firms and the Government is able to identify the investments which will achieve high social and/or private returns or can encourage financial intermediaries to focus on such investments. Even if the amount of public money spent in such programs is modest if compared to the public expenditures, these programs have a fundamental importance in stimulating the innovative firms. The Government involvement in such programs could be either direct or indirect; the first approach refers to the direct financing of entrepreneurial firms while the second refers to the initiatives that encourage or subsidize the development of private investors. The public venture capital initiatives are programs which require equity or semi-equity investments in innovative firms or that encourage institutional investors to do such investments. Even if the structure of these programs is fundamental in order to maximize their effectiveness, there are few studies which address the study of their financial structure. The information asymmetries between entrepreneurs and investors could cause problems in the identification of the correct mix of debt and equity; without the information gap the financing constraints would disappear. The rationale underpinning the public venture capital programs is that the Public Sector could play an important role in the certification of the firms to private investors; the certification effect would attract new investors and, therefore, would allow the firms to gather the resources they need to succeed. The Governments and the legislative framework are fundamental to energize the private equity market. First of all, the legal and fiscal frameworks define the context in which the investors will operate and, therefore, the main characteristics of taxation/protection, flows of capital and partnerships' structure. The intervention of the Public Sector could not always be effective; according to Leleux and Surlemont (2003) the direct intervention of the Public Sector in venture capital funds is counterproductive because the public fund managers are often civil servants and governments employees, thus not having the experience to select and support the companies. Therefore, there are two main negative potential effects to consider in public venture capital: first of all, the capital can be misallocated and, secondly, there can be the crowding out of the Private Sector because of the creation of new entry barriers against the company that the governments actually claim to support.

4.2 Innovative Model Based On Public Private Partnership

The public policies have to be efficiently and effectively addressed to support the growth of enterprises and in particular of the Family Firms. Considering the fundamental contribute of Family Firms in enhancing the economic development of a territory, the main purpose of this study is to propose a new public policy which can favor not only the size growth of Family Firms but mainly the reaching of the critical mass to let these enterprises to survive in a more and more competitive and turbulent market. The Public Sector should facilitate the creation of a network of enterprises as well as attracting private investors to finance the whole network; therefore, the establishment of a partnership between the Public and Private Sector is fundamental to sustain a network of enterprises. The difference with the traditional scheme of intervention is the support of a whole network of firms, and not of single enterprises, because the network by itself can favor the innovation process among the different enterprises. Moreover, the Private Sector will be engaged in the financing of the whole network and, therefore, there will be an intrinsic diversification of the investment risk.

Enterprise Network

The enterprise network has many advantages for the Small and Medium Enterprises which usually are 'too small to survive' by themselves. The network, in fact, thanks to the integration of the expertise, information and material resources, can favor their innovation and internationalization process. The rationale underpinning the creation of a network is that the whole performance of the network is higher than the sum of the single firms' performances. The public policies should therefore favor the creation of networks within the sectors that, by their very nature, create positive externalities. Given the necessity of Public and Private assistance to sustain the Family Firms, the network would be more cost-effective than the assistance to individual enterprises thanks to a reduction of transaction costs. The network would also allow the firms to have a better access to qualified or highly specialized management thanks to the links with other enterprises and investors.

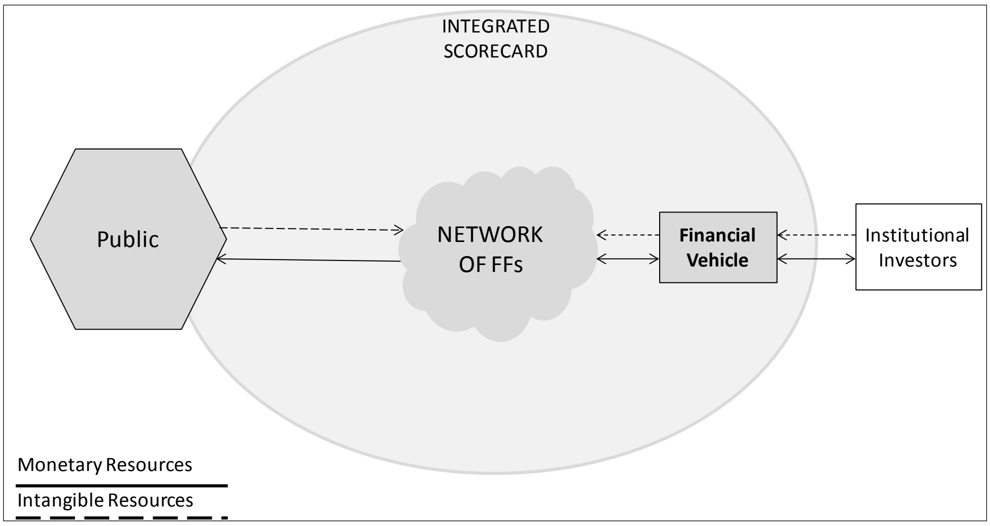

Figure 1 - An Innovative Model Based on a public private partnership

The Graph shows the innovative model of intervention based on a public private partnership which enables the creation of an enterprise network. The aim of the enterprise network is to attract institutional investors which represent a potential source of financial resources. Therefore, the resources converging in the network could be both Public and Private; whilst the first supplies intangible resources, the latter makes available both tangible and intangible resources.

The relevant phenomenon of the equity gap, which is characterizing the Small and Medium Enterprises is even more significant for Family Firms because, in addition to the previously mentioned barriers, they strictly rely on the banking system and moreover, in most cases, the family cannot follow the growth of the firm. The Family Firms are characterized by a lack of intangible resources - such as know-how and expertise- which, together with the financial resources, are fundamental to enable them to reach the critical mass to internationalize and innovate. Nevertheless, the network addresses to a specific group of Family Firms which satisfy a series of requisites whose main are:

- The enterprises have to be categorized as SMEs, according to the definition provided by the European Union;
- The enterprises have to be strongly innovation oriented;
- The enterprises have to belong to sectors which create positive externalities;

- The enterprises have not to be in financial restructuring;
- The enterprises could belong to the lifecycle phase of start-up, growth or maturity but not to the decline phase.

Given the relevant opportunity offered by the network and in order to avoid the problems of adverse selection and moral hazard, the Family Firms wishing to enter the network should pay an annual fee to the Public Sector.

The creation of the network requires a preliminary feasibility study; in fact, it is necessary to analyze the characteristics of the context, the entrepreneurial tissue and the normative and regulatory framework. Moreover it is important to clearly define which are the objectives of the network and the role of the different actors involved. The network requires the definition of a preliminarily established life period, divided into three sub-periods:

- The Pre-entry period, during which the Public Sector define the main requirements of the network;
- The Entry period, during which the enterprises can join the network;
- The Hold period, during which the enterprises should remain in the network, except for the cases of default of the firm or opportunistic behavior which could hinder the collaboration within the network and jeopardize the win-win strategy;
- The Exit period, during which are defined the different exit strategies for the Public and Private Sector.

An analysis of the international PPI has allowed to make an estimation about the time duration of each period. The Pre-entry and Entry period are estimated in a unique time slot which is about two years; this time duration is higher than what is assessed by the analyzed international PPIs[2] because it requires the creation of a network. At the state of art, in fact, there are many programs of Public Private Partnership to support the innovation process – Certified Capital Company, Finnish Industry Investment, Innovation Investment Fund, Small Business Investment Company, Regional Venture Capital Fund, Venture Investment Program, Yozma - but none of them requires the creation of an enterprise network or the support of Family Firms; the majority of them addresses innovative start-up enterprises and, moreover, they require a monetary intervention of the Public Sector. The following section will give a detailed description of the Public and Private intervention in this innovative model.

PUBLIC SIDE

The difficulties of the Small and Medium Enterprises in access to credit have highlighted the necessity of the intervention of the Public Sector which has to choose the instrument best able to catalyze the resources and to enhance the growth. It is therefore necessary to identify the solution which maximize the benefits for the

[2] Appendix: Table 4.

socio-economic context and for the Private Sector involved in the operation, which is an indispensable source of tangible -capital- and intangible resources -expertise, know how-.

The main objective of the Public Sector is to enhance the socio-economic development of a territory by creating favorable conditions to the growth of the enterprise system. The Public Sector, aware of the role of Family Firms in the development of a territory, has always implemented a variety of policies which could support, in particular, the Small and Medium Enterprises in order to stimulate their innovation capability. As previously reported, such policies can be clustered into three main groups: direct monetary, indirect monetary and non-monetary intervention. The first two forms of intervention require a financial engagement of the Public Sector causing an increase of the expenditures or a decrease of the tax revenues. The monetary intervention of the Public Sector should be better analyzed in light of the current Public finance crisis, the possible crowding out of the Private Sector and the possible moral hazard of the counterpart. The recent crisis has deeply hit the economic tissue as well as the Public Sector's financial capacity; therefore, the increasing financial needs of enterprises strongly clashes with the shortfall of resources of the Public Sector. The Public Sector has always supported the enterprise system through direct monetary intervention which, nowadays, is no more fully implementable. The crisis has increased the issue of the guarantees and the Public Sector expenditures; moreover, the shortfall of resources has limited the loans to the enterprise system which, at the same time, has become more risky and less stable. In addition to the problems of the financial crisis, a non well targeted monetary intervention of the Public Sector could generate the crowding out of the Private Sector and thus might create disincentives to the private investments. Finally, not well addressed public incentives could induce the moral hazard problem which leads enterprises to act in an opportunistic way. Given the relevant problems of the monetary intervention, the Public Sector have to enhance the innovation process within the enterprise network through non-monetary policies. The non-monetary policies could be, for example, the regulatory intervention, the enhancement of new entrepreneurial initiatives and the supply of expertise and services. Not all of the non-monetary policies are suitable for the enterprise network and in particular, the supply of expertise should be in charge of the Private Sector. The Public Sector, in fact, does not have the specialized expertise which is necessary to the innovation process within the network; moreover, the intervention of the Public Sector in the supply of the expertise could create conflicts between the Public and Private Sector. The Public Sector should therefore have specific roles during the whole life of the enterprise network in order to truly create the conditions for the growth of Family Firms and to attract private investors.

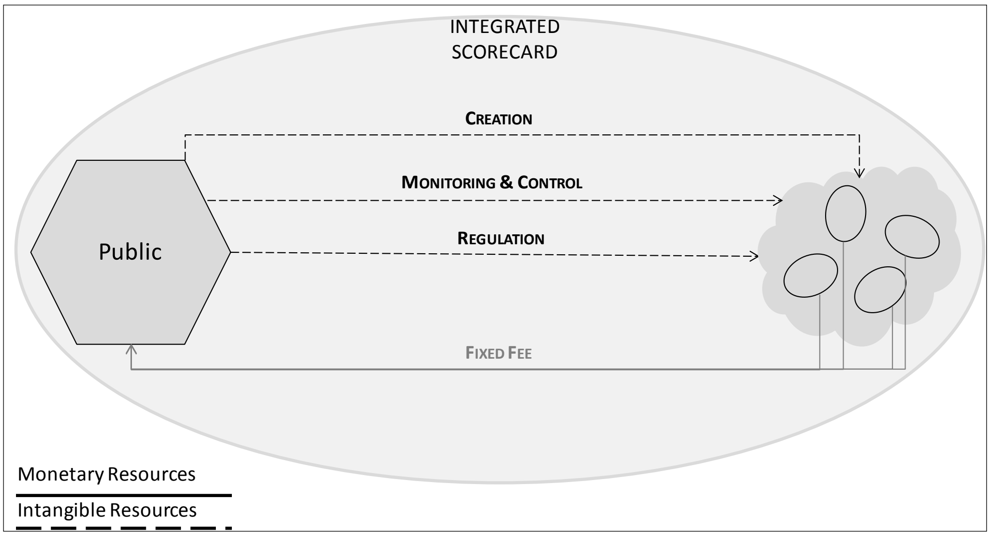

Figure 2 - Flows between Public Sector and Enterprise Network

The Public Sector is the promoter of the initiative and has to define the preliminary conditions for the network creation; therefore, during the *Pre-Entry Period* the Public Sector has a regulatory role. First of all, it is necessary to clearly define the objectives, the expected results and the characteristics of the network in terms of sector/s of implementation, geographical area, number of years of implementation and the participants' behavior rules. Secondly, it is important to describe the requirements of the Family Firms which can join the network in order to avoid moral hazard and adverse selection; these requirements have to be monitored during the whole life of the network. Moreover, the Public Sector has to transparently define the entry procedures and the application form. The network will be financed by institutional investors thanks to a financial vehicle and, therefore, the Public Sector would have to clearly define its objectives and the requirements of the investors involved. The regulation of the financial vehicle will result from a negotiation between the Public and Private Sector. During the *Entry Period* the Public Sector has a monitoring role; in fact, it is necessary to control the building of the financial vehicle and the entry of the enterprises. During the *Hold Period* the Public Sector has to monitor the respect of the behavior rules and of the requirements of both the enterprises and the financial vehicle. The Public Sector has to facilitate the internationalization process which can be enhanced by creating relationships between the network and universities, foreigner enterprises and other centers of expertise. Furthermore, it is necessary to facilitate the integration of the enterprises by favoring the flow of information within the network. Finally, at the conclusion of the network contract, the Public Sector has to arrange the *Exit Period* which requires the closing of the financial vehicle. During this phase it is very important to measure the results of the network through a specific Integrated Scorecard and deriving a lesson learned for future improvements.

This policy does not require any investment in charge of the Public Sector and therefore has a limited impact on the public balance. Moreover, the enterprises which have been selected to be part of the network should pay an annual fee to the Public Sector; the annual fee has to cover part of the fixed and administrative costs of the network. The fee should be lower than the fixed costs that the firms would otherwise have been paying to join a network without the Public support. The fee is useful also to disincentive opportunistic behaviors of the enterprises and to avoid the adverse selection.

INTEGRATED SCORECARD

The Public Sector, which is the promoter of the initiative, has the role of measuring the achievements of the network. Considering that the Public Sector has mainly socio-economic objectives while the Private Sector has financial objectives, it is important to define a tool -Integrated Scorecard- suitable for the monitoring of both the aspects.

First of all, it is necessary to define the evaluation methodology: the analysis could be undertaken following a 'after and before', 'with or without' or 'expected and actual' logic; the first approach requires the definition of a specified time horizon, thus, the performances will be evaluated on a time - relative basis. Nevertheless, this methodology is affected by a time bias which could distort the analysis because it does not take into consideration the dynamism of the context and, consequently, cannot assess which is the real contribute of the network to the context performances. The 'with or without' logic could be more suitable but, at the same time, more difficult to define; this methodology requires to estimate what would have been the performances of the territory without the implementation of the network. Establishing the counterfactual is very difficult and this methodology cannot be easily implemented. The Public Sector could therefore use a different approach which relies on the study of variance between 'expected and actual' results. For the purpose of implementing this methodology it is important to clearly set the expected results; in order to be as much realistic as possible it is necessary to periodically review these expectations considering the dynamism of the context. After having compared the achieved results and the expected results, it is necessary to undertake a variance analysis; each difference between expected and actual result has to be analyzed in light of the dynamism of the context and, therefore, it is possible to assess the net contribute of the network. This methodology could be affected by an optimistic/pessimistic bias of expectations and by an inaccurate analysis of the variance; nevertheless, the 'expected and actual' is the best approach suitable for the purpose of the network evaluation.

After having defined the methodology, it is necessary to identify the main indicators which will compose the Integrated Scorecard. The socio-economic objectives are related to the positive impacts that the growth of Family Firms, enhanced by a network, could bring to the development of a territory. The impact of the network on a territory could be evaluated through both direct and indirect indicators; the direct impact could be measured in terms of job turnover and the indirect impact could be assessed in terms of changes in GDP or tax revenues. Moreover, it is necessary to assess the real growth of the network, mostly in terms of innovation - e.g. number of patents- and internationalization -e.g. export revenues-. Together with the definition of the socio-economic results it is important to evaluate the financial results achieved by the private investors in the network. The Private Sector has financial objectives which are traditionally measured in terms of Internal Rate of Return and growth of the network revenues.

PRIVATE SIDE

Modigliani and Miller (1958) were among the firsts to deal with the issue of the financial structure of firms; the 'Irrelevance Theory' proofs that the value of a firm is not related to its financial structure. Nevertheless, the validity of this proposition is subjected to the strong assumption of the perfection of markets. Considering that this strong assumption could distort the value assessment of a company, Donaldson (1961) and Myers (1984) have defined a more representative model, the "Pecking Order Theory", which shows the preferences of the firms in the choice of the financing sources: self-financing, debt financing and risk capital financing. This theory is in line with the preferences of the Family Firms which tend to maintain the control of the company and to not open the property to third parties; from this derives an excessive debt of many Family Firms. Some authors (Stiglitz and Weiss, 1981, Carpenter and Petersen, 2002) have highlighted the unsuitability of forms of intervention based purely on debt which cannot well address the financing and growth need of firms. From the American and European experience, it is possible to evidence that the firms owned by Venture Capital and Private Equity Funds are dynamic and contribute to the innovation and growth of the economic system as a whole. The shift from loan-based to equity-based financing have to be reconsidered in light of the Equity Gap phenomenon that was evidenced for the first time in United Kingdom (Macmillan Report, 1931); the Equity Gap refers to the lack of risk capital during the first phase of an enterprise lifecycle. The mismatch between the demand and supply of risk capital is an issue which also the mature and usually small and medium size enterprises have to face.

The preferability of equity-based instruments, rather than loan-based, together with the contextual liquidity crisis of the banking system, highlights the need to define alternative tools for the financing of innovation, internationalization and integration; these tools have to expand the resources available to firms and in particular to a network of firms.

The mezzanine finance offers a number of significant advantages for the issuer of the debt, some of which are differential compared to the traditional debt, especially thanks to the considerable flexibility of this kind of financing. In some cases, especially if the debt of the company is particularly high - as in many of Family Firms - the traditional sources of funding are not always accessible. Therefore, the mezzanine finance may represent a strategic opportunity that allows to diversify the debt structure and, on the other hand, to attract a wider and varied range of potential lenders. As stated by Forestieri and Tasca (1994), the advantages of the mezzanine are particularly significant for a company with strong financial needs of internal growth (financing an investment project) and/or external growth (financing of an acquisition). The mezzanine is highly appropriate to fund the business growth because, by its very nature, it is issued on the basis of the prospects of development and generation of cash flows of the company financed, rather than on the basis of collaterals, as in the case of senior debt funding. This also implies that the firms which have a lack of collaterals but with good growth prospects might obtain the financial resources they need. Finally, the mezzanine financing has an additional advantage for the financing of firm growth: the long term orientation due to both the equity kicker claim (issued in the event of default of the target enterprise) and the repayment of capital which is delayed compared to the senior debt. In contrast to the current short-term orientation of the banking system generated by the liquidity crisis, the mezzanine, thanks to its long-term orientation, is defined as a hybrid (semi-equity) instrument that provides funding as a complement to risk capital investments in innovation. In addition to the advantages, the mezzanine is characterized by some weaknesses among which the main one is the cost of funding. Nevertheless, considering the current historical period, it cannot be interpreted as a disadvantage when compared to the tightening of access to the traditional bank debt by the Small and Medium Enterprises and, even more, by Family Firms. In the absence of mezzanine finance, there are only two forms of financing which stand at the polar opposites in terms of risk-return profile: the risk capital and the debt capital. The financing through mezzanine should not replace the other resources, but it has to be configured as an instrument able to attract new investors thanks to its varied and flexible characteristics.

The Figure below shows the flows of resources which are both tangible and intangible. The monetary resources from the Private Sector to the network are, preferably, in form of equity or semi-equity because this form of financing best suit the objective of growth of the enterprises and the achievement of the 3Is.

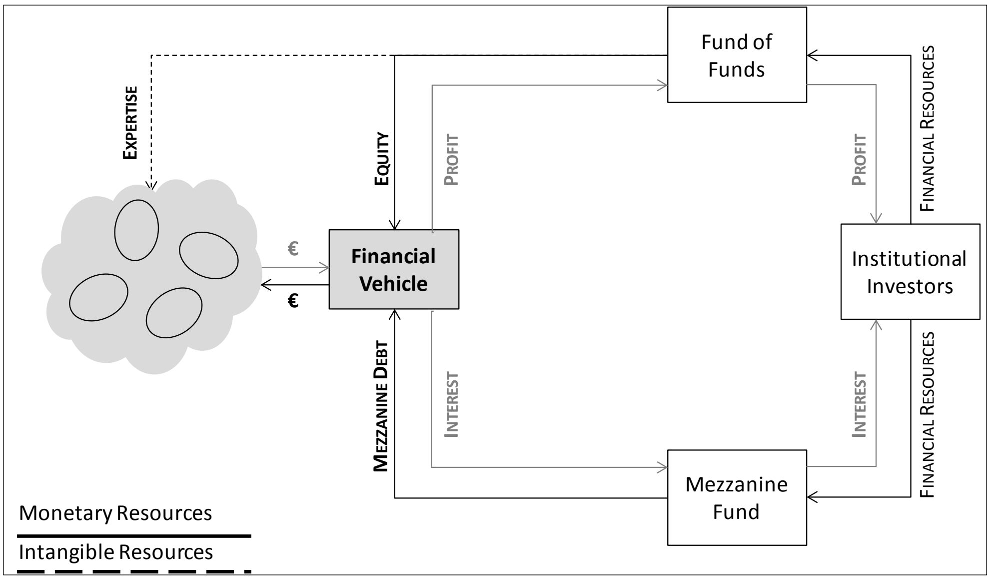

Figure 3 - Flows between Private Sector and Enterprise Network

The institutional investors, through a Fund of Funds and/or through a Mezzanine Fund, may invest in equity or mezzanine debt in a Financial Vehicle which, in turn, invests both equity and mezzanine debt in the network of enterprises and not in individual companies. The monetary flows from the network to the Private Sector refer to profits to repay equity and reimbursements - capital and interests - to repay the mezzanine debt. The risk capital, if compared to the debt capital, is more oriented to the long period and seems to be one of the most effective instruments for the development of the business. Therefore, it is important for the Public Sector to attract resources from the Private Sector rather than undertake sole direct investments; moreover, along with the supply of financial resources, the Private Sector could supply professional experience. The enterprise system, in fact, has to face not only a lack of tangible asset -

availability of resources - but also of intangible assets such as skills. Therefore, the role of the Private Sector is also to bring know-how and expertise which are fundamental to the long-term survival of firms. Among the main barriers that hinder the growth of the FFs, in fact, there is the presence of a management that wants to favor the interests of the company, but that does not have the managerial skills necessary to promote the business growth. The achievement of the 3Is network objectives requires the presence of a qualified and competent management who is proactive and has a good knowledge of the business.

5. MAIN CONCLUSIONS AND POTENTIAL DEVELOPMENT

MAIN CONCLUSIONS

The relevance and the strategic role of Family Firms in supporting the economic development of a territory has stimulated a variety of Public Policies. Moreover, in a global economy characterized by critical success factors such as Integration, Internationalization and Innovation, there is an urgent need to promote new forms of Public intervention. One of the priorities for Governments is to identify the strategies and policies to support the enterprise system by promoting adequate funding and limiting, as much as possible, the problems of the access to credit. Empirical evidence shows that the availability of resources for the financing of the business is a prerequisite for the survival of FFs and, therefore, for the enjoyment of the future economic benefits that they could generate. Nowadays, the FFs' funding depends excessively on bank credit which is the major, if not the unique, source of financing. At the state of art, FFs do not have adequate resources to conduct their business and, consequently, they face difficulties in improving their competitiveness. Compounding the situation, the proprietorship of the Family Firms often overlooks growth opportunities and, moreover, an increasingly competitive market could jeopardize the survival of Family Firms which are not enough equipped to undertake a strategic repositioning. Considering the fundamental contribute of Family Firms in enhancing the economic development of a territory, the main purpose of this study is to propose a new public policy which can favor not only the size growth of Family Firms but mainly the reaching of the critical mass to let these enterprises to survive in a more and more competitive and turbulent market.

The proposed innovative model is based on a public private partnership set in order to stimulate the growth of Family Firms. The network could overcome the traditional problems of the Family Firms by enhancing Innovation, Integration and Internationalization (3Is).

SMEs which are backed by Venture Capital funds are particularly dynamic and contribute to the innovation capacity, economic growth and creation of new jobs of a country. Therefore, the reduction of barriers to growth and the improved access to equity capital for Family Firms, through the intervention of Fund of Funds, can bring important benefits to the innovation capacity and economic growth. The FFs are characterized by the resistance in losing the control of the firm and, therefore, they are adverse to finance their activities with risk capital; consequently, the Family Firms strictly rely on the banking system. The current credit crunch has worsened the already existing problems of the access to credit. The FFs, which are characterized by a lack of collaterals but with good growth perspectives, might obtain the financing they need thanks to both equity and hybrid instruments such as mezzanine debt. This instrument is highly appropriate to finance the business growth because it is issued on the basis of the prospects of development and cash flows of the firms financed. Therefore, the equity capital and mezzanine finance may represent a strategic opportunity that allows to balance the financial structure and to attract a wider spectrum of potential institutional investors. If the Family Firms are not proactive they will be not able to survive because they would be destined to lose their financial independency as well as the ownership and control of the firm. The high risk perceived by institutional investors does not allow the promotion of the growth of Family Firm and, therefore, the proposed model gives a viable opportunity to avoid the envisaged decline. However, the role of Private Sector does not end with a monetary intervention but it extends also to the supply of expertise and managerial competences. Among the main barriers that hinder the growth of FFs, in fact, there is the presence of a management that wants to favor the interests of the company but that does not have the adequate managerial skills to enhance the business growth. Within the Enterprise Network the Private Sector would enhance the value creation through the supply of vocational expertise and know-how.

The Public Sector is responsible for the creation of the network and for the integration and internationalization process. Therefore, the Public Sector has to facilitate the flow of information in the network and has to favor the contacts of the network with external entities -such as universities or foreign enterprises-. The Public Sector would sustain the Enterprise Network only through intangible resources, therefore, it would not have any role in the financing process. The non-monetary intervention of the Public Sector would avoid the crowding out effect of the Private Sector, the possible opportunistic behaviors of the counterpart and, not of less importance, would not impact on the Public Sector financial situation.

The proposed model aims to maximize the benefits for all the actors involved. The Private Sector would benefit from a certification effect due to the Public Sector commitment; moreover, the financing of the whole network, and not of the single enterprises, would allow a portfolio diversification. The Family Firms would have, thanks to the network, a viable opportunity to survive and to be competitive in the long run. Finally, the Public Sector would benefit from the network creation because of the potential positive impact of the growth of Family Firms on the territory.

POTENTIAL DEVELOPMENT

The Enterprise Network proposed in this article is an innovative model based on a public private partnership scheme. At the state of art, this innovative model has never been implemented; therefore, the current section aims to assess its potential implementation. In order to verify the suitability of a territory for the model, it is necessary to analyze the weight of FFs on the enterprise system, the financial structure of Family Firms and the conditions of access to credit. The following analysis is based on the characteristics of the Italian territory.

Italy is a country permeated by the widespread presence of FFs: they represent almost the ninety percent of total business and have a weight equal to the ninety percent of GDP. The Italian index FTSE MIB is composed by thirty percent of Family Firms which are often identified as Small and Medium Enterprises[3]. In Italy, in fact, the FFs are the ninety percent of SMEs which, in turn, are the 99,9% of the Italian enterprise system[4].

For the purpose of analyzing the financial structure of FFs, in 2011 an analysis has been conducted on a sample of 30000 Italian Small and Medium Enterprises. The analysis shows that the financial structure of Family Firms is characterized by a high leverage; the debt, in fact, is in average three times the equity value. Thence, it is necessary to balance the mix of debt *vs.* equity with the aim of building a balanced financial structure that hopefully allows not to run into phenomena that could compromise the sustainability of debt. The access to risk capital, however, is hampered by the high level of risk perceived by investors and, therefore, it is important to find alternative sources of funding. In the current scenario, most of the FFs depend on the banking system which, however, cannot follow the growth of the businesses in the long run; the reform envisaged by Basel III contributes to the compounding of the situation. Meanwhile, the debt capital could endanger the growth of the companies because it does not favor the development in the medium and long-term, especially if considering the current economic downturn. The slowdown of the economy has caused the liquidity crisis in the banking system with a consequent tightening of lending and a change in the priorities that increasingly favors short-term investments, not suitable to finance the business growth.

Another result highlighted by the analysis is the weight of short-term component of debt which amounts to eighty percent; this percentage shows a weakness of the SMEs' financial structure. In fact, a high value of the ratio of short-term debt is a symptom of an imbalance that could undermine the robustness of a company and its ability to meet debt service. The conditions of the Italian FFs are more vulnerable because of the large share of their short term debt, which is characterized by a prevalence of floating rate contracts - EURIBOR + Spread - which contribute to amplify the potential impact of an increase in market rates. In general, the competitive capability and the economic growth of a territory depends on many factors, including the specialized production, the presence of a favorable context for innovation and the intensity of research and development activity; these factors can be stimulated only by risk capital investments. In this regard, the data collected by the Bank of Italy are not encouraging; the investment activity of private equity funds and venture capital has fallen consistently during 2010 and, therefore, despite an increase in the number of operations, the average size of the deal has decreased[5].

The data on the financial structure of the Italian Family Firms highlight the potential benefits of the implementation of the proposed instrument on the Italian territory. In fact, due to the high percentage of

[3] Source: Italian Private Equity and Venture Capital Association (AIFI).
[4] Source: Italian National Institute of Statistics (ISTAT).
[5] Cfr. Bank of Italy (2010). *Geographical break down of credit supply and demand in 2010.*

FFs on the enterprise system, the need of an easier access to credit and the necessity to finance Innovation, Integration and Internationalization, the proposed model - an enterprise network based on public private partnership - could favor the growth of FFs and overcome their financial constraints.

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Appendix

Company category	Employees	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ € 50 m		≤ € 43 m
Small	< 50	≤ € 10 m		≤ € 10 m
Micro	< 10	≤ € 2 m		≤ € 2 m

Table 3 - European Union Definition of Small and Medium Enterprises (Source: European Commission)

Name of the Program	Description	Investment Period
CAPCO (Certified Capital Company)	This program was born in 1996 in the U.S. to support the development of SMEs operating in the country	From three to seven years
FII (Finnish Industry Investment)	Finnish Industry Investment Ltd is an investment company owned by the Government. Born in Finland in 1995 has enabled funding 87 portfolio companies and holds 440 (financed directly or through funds)	From five to ten years
IIF (Innovative Investment Fund)	It is a program, born in Australia in 1998, that promotes the commercialization of the research enterprise	Ten years
RVCF (Regional Venture Capital Fund)	Funds born in 2002 in the United Kingdom (UK) to provide risk capital to SMEs operating in the territory	Ten years
SBIC (Small Business Investment Company)	This program was born in 1958 in the U.S. in order to provide venture capital to small new or existing businesses	From seven to ten years
VIP (Venture Investment Program)	It is a program, born in Oklahoma in 1993, thanks to OCIB (Oklahoma Capital Investment Board), which includes investments in private Venture Capital funds.	From ten to twelve years
YOZMA	Yozma is a fund, established in 1993 in Israel, which makes equity investments in Israeli technology companies.	Five years

Table 4 - Analysis of Investment Period for seven international public private partnerships

DESCRIPTION	Innovative model based on public private partnership capable to enable the creation of an Enterprise Network composed by Family Firms
AIMS AND OBJECTIVES	Enhancing the growth of Family Firms (3Is: Innovation, Integration, Internationalization)
SCHEME	FFs have to pay an annual fee to the Public Sector in order to cover the fixed costs of the Network. Public Sector is responsible for the creation, regulation and monitoring of the Network; while the Private Sector (Institutional Investors that create Fund of Funds and Mezzanine Funds) could invest in the Network through a Financial Vehicle
FINANCIAL RESOURCES	Institutional Investors finance the Enterprise Network through Equity Capital and/or Mezzanine Fund
MAIN REQUIREMENTS	• FFs within EU definition of SMEs • Innovative FFs • Sectors which create positive externalities • FFs not in financial restructuring • FFs not belonging to the decline phase
MAIN ACTORS	Public Sector, Private Sector (Institutional Investors), Family Firms
ROLE OF THE PUBLIC SECTOR	Non-monetary intervention: Regulatory role and Monitoring. Considering the 3I objectives, the Public Sector is responsible for the Integration and Internationalization of the Enterprise Network
ROLE OF THE PRIVATE SECTOR	Financial resources and expertise. Considering the 3Is objectives, the Private Sector is responsible for the Innovation and Internationalization of the Enterprise Network
GEOGRAPHICAL AREA	National level
INVESTMENT SECTORS	Sectors that create externalities
INVESTMENT PERIOD	The investment period is divided in: • Pre-Entry and Entry Period: two years • Hold Period: six years • Exit Period: two years
CAPITAL REIMBURSEMENT	A part of cash flows generated by the Enterprise Network is used to repay Institutional Investors through: • Profit • Interests • Debt Capital
IMPACT	The growth of the FFs is measured through an Integrated Scorecard in which converge socio-economic (job turnover, GDP growth, number of patents, etc.) and financial indicators (IRR, Network's Revenues, etc.)

Table 5 – The Enterprise Network