

V: VENTURE CAPITAL FOR CO-OPERATIVES

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In the varied world of private equity, venture capital is generally considered the financial sector dedicated to the investment of risk capital (but sometimes of debt and/or of 'hybrid' capital) in start-up firms with a potential for growth (Bracchi and Gervasoni, 2006).

Historically, venture capital took flight in the United States in the 1950s with the financing of spin-offs of university research projects, but became internationally associated with high-risk investments in Information Technology-related activities in the area known as 'Silicon Valley' at the end of the last century (Kenney, 2000: 98 ff.).

Although it expanded rapidly in the United States, venture capital has spread very slowly in Europe and achieved minimal results. In 2012, according to data provided by the EVCA (European Private Equity and Venture Capital Association), approximately 500 companies in the venture capital sector financed fewer than 3,000 projects during their start-up phase with an overall investment of € 3.2 billion (equivalent to 0.2 ‰ of the community GDP), which represents only one third of the amount invested in the same year by venture capital companies in the San Francisco area alone.

However, the analysis of this data reveals another trend in European venture capital: nine countries in Northern Europe account for approximately 90% of total investments (60% of which are concentrated in Britain, France, and Germany, totalling almost €2 billion) leaving less than 10% of total venture capital resources to the other national economic systems. In 2012, Italy recorded venture investments amounting to 1.7% of the European total with a total figure of only € 60.5 billion, equal to 0.04 ‰ of the Italian GDP (a fifth of the European average).

It is therefore quite reasonable to say that venture capital (for-profit) in Italy is microscopic and almost non-existent. Even so, the importance of this method of business financing is widely recognized not only by a majority of businesses, but also by the Italian government, which has recently introduced legislation that aims to encourage the creation and financing of innovative start-ups (Law no. 221/2012: Munari, 2014: 116) and has invested (through *Cassa Depositi e Prestiti* SpA) significant public resources in the capitalization of investment funds devoted to this specific form of investment (including € 100 million in 2014 for participation in



venture capital funds: press release of Cassa Depositi e Prestiti SpA no. 29 issued on 28 May 2014).

However, this lack of success in Italy cannot be attributed to a lack of firms capable of undertaking venture capital activities. In addition to over 100 private-equity companies that belong to the AIFI (Italian Association of Private Equity and Venture Capital) and just as many angel investors who are part of IBAN (Italian Business Angel Network Association), venture investment could be implemented, at least in theory, by the 90 or so banking institutions (*fondazioni bancarie*) and 500 or so pension funds operating in Italy (without considering the numerous players in the banking and finance industry, over 200 insurance companies and 20 or so pension institutions which could allocate a small amount of their investments to this specific activity). A lack of cultural development in Italian corporate finance therefore seems to be to blame for these disappointing results.

In light of this, the data for the non-profit sector of venture capital in Italy appears to be even more positive than it actually is, as, for twenty years, Italy has been able to count on stable annual funding of over € 30 million and a volume of recurring investments of almost € 400 million, almost seven times the total of for-profit venture capital investments in 2012.

This paradoxical success of mutual venture capital lies in a clever, albeit somewhat fortuitous, idea of Law no. 59 of 31 January 1992. The main idea, which is relatively simple, is based on the need to resolve a problem that arose as an undesired effect of complex legislative stratification. The starting point was the famous ‘mutual requirements’ as outlined in Article 26 of the ‘*Basevi Law*’ (Temporary Head of State Legislative Decree no. 1577/1947).

As is widely known, after repression of co-operative movements during the Fascist period, renewed interest in private, non-speculative mutual enterprises (culminating in the recognition of the social function of co-operation in Article 45 of the 1948 Constitution) led to the immediate reintroduction of an integrative discipline of the Civil Code aimed at allowing the co-operative movement to develop and expand against a backdrop of tax relief and government controls to prevent ‘false co-operation’, i.e. against organizations which, under false premises, pursue goals which are not genuinely mutual but purely lucrative.

More specifically, the 1947 law limited the use of tax benefits to co-operatives that included ‘non-profit’ clauses in their statutes defined by the legislature as prohibiting the distribution of profit (and, therefore, as obliging these positive margins to be allocated to reserves), prohibiting a division of reserves created using retained earnings and obliging co-operatives ‘altruistically’ to transfer these public assets to ‘public utility’ purposes if they dissolved.



Thirty years after the first provision was introduced, co-operative self-financing was strongly consolidated by the equally well-known legal provision (partly still in force) outlined in Article 12 of Law no. 904/1977, which provides tax relief (currently only partial) for earnings retained as indivisible reserves (to be used for altruistic purposes).

Conceived in such a way, the system had the indisputable merit of facilitating the capitalization of companies that were financially weak due to their natural inability to remunerate the invested risk capital; however, it was not without its drawbacks.

One problem arose as a result of a lack of legal provisions regarding the fate of indivisible reserves (created with tax-free profits) if a co-operative was transformed into a profit-making company; after generating discussion and uncertainty for a quarter of a century (Bolaffi, 1948: 444; Ferri, 1951: 57; Ascarelli, 1956: 777; Verrucoli, 1958: 415; Oppo, 1959: 369; Scordino, 1970: 504), this loophole was overcome, first of all, by the introduction of a ban on transformation as outlined in Article 14 of Law no. 127/1971 and, subsequently, by the legal provision which imposed an obligation to transfer indivisible assets at the time of transformation (heterogeneous) as outlined in Articles 2545-decies and 2545-undecies of the Civil Code.

The second, more complex problem lays with the legislature's choice to leave a specific identification of the person to allocate the co-operative's indivisible assets only to when dissolved to the same 'debtor' (i.e. to the co-operative's statute and its liquidator).

Indeed, the absence of a 'rightful claimant' to the assets remaining after paying the company creditors and returning social capital to the co-operative members, tended to stimulate, perhaps inevitably, a widespread practice of endless settlements which were extremely costly and lacked residual resources to be transferred for public use. What's more, those benefiting from the allocation, being chosen by the same person who was responsible for allocating the assets, were hardly motivated to criticize such liquidation methods used to assign the assets free of charge in their favour (Cardarelli, 2009: 269).

It is therefore to eliminate the strong temptation to proceed with 'inefficient' liquidations that Article 11 of Law no. 59/1992 pre-identified *ex lege* the legal entities (future) that would receive the indivisible assets of the liquidated or transformed co-operatives in the so-called 'mutual funds for the promotion and development of co-operation'. The resulting potential conflict between entities with opposing interests (which often led to legal proceedings whose aim was to ascertain the true value of the assets to be



transferred: Court of Cassation, 14 July 1997, no. 6349; Court of Matera, 6 May 2003; Court of Mantova, 17 March 2009) actually had a positive moralizing effect on the previous (not very commendable) practice.

The legislature, at the time, introduced two additional precise and 'revolutionary' legislative requirements: a mandatory annual transfer of 3% of the profits gained by the co-operatives, and the mandatory assignment of resources from these funds for the 'promotion' and the 'financing of new projects and undertakings for the development of co-operation, with a preference for programmes that focused on technological innovation, an increase in employment and the development of Southern Italy' (with the possibility of 'organising professional training courses for the administrative or technical personnel in the co-operative sector, promoting studies and research on economic and social issues of significant interest to the co-operative movement').

On the basis of these legislative provisions, over the next twenty years the co-operative system in Italy implemented, promoted, and developed an advanced co-operative venture capital system with a series of figures that merits attention.

A quick look at the 2013 financial statements published by the mutual funds promoted by the three central co-operatives belonging to the Italian Co-operative Alliance (Legacoop, Confcooperative and AGCI) gives a full picture of the situation. Cumulatively, these entities – despite the clear economic difficulties that hit co-operatives along with other companies – managed to raise annual mutual contributions in 2013 that amounted to over € 35 million and were therefore able to rely on total assets of over € 600 million, of which over € 370 million were used for participation in the capital of the co-operative members, over € 130 million for financing co-operative members, and approximately €100 million for treasury investments (mainly government securities and bank bonds).

Although the overall volume of investments (temporary and recurring) used for both risk capital and loan capital purposes represents over 80% of available assets, it is worth noting (and analysing) the tendency of the three funds to concentrate risk investments in virtually the same way and, as well as the considerable difference in the way that they achieved their objectives.

As far as the concentration of investments is concerned, we can see that while the largest of the three funds (Coopfond SpA) used 85% of their resources allocated to venture capital investment to finance the 50 largest businesses (among the over 250 investees, 20% of its own businesses) by reserving over € 153 million for the five largest businesses (over 60% of the total resources used for this purpose), the second largest



enterprise (Fondo Sviluppo SpA) used over 80% of its total resources allocated to venture capital investment to finance the 10 largest businesses, by reserving over €75 million to the five largest businesses (70% of the total resources used for this purpose). In the same way, the smallest of the three funds (General Fond SpA) used 70% of its total resources allocated to venture capital investment to finance the five largest businesses.

With regard to the way they achieved their company's objectives, it should be noted that whereas Fondo Sviluppo SpA tends to use significant resources in ventures that promote the co-operative system rather than direct investment in co-operative assets (allocating for this purpose, in 2013 alone, over € 15 million, which amounts to two thirds of the total mutual contributions received throughout the year, € 20 million), the other two funds allocated almost all their own resources to financial type investments (so much so that in 2013 Coopfond SpA obtained a total overall yield of roughly € 12.5 million from its own investments, which is almost the same amount received by paying its compulsory annual mutual contributions).

Further, the most recent tendencies in mutual investment include the commendable financing of worker buyouts, i.e. the acquisition of a company by its workers who, by the use of mutual funds, can rely on other financial resources in addition to those legally available due to the right granted to workers (as outlined recently in Article 11 of Decree Law no. 143/2013) to obtain advance payment of the INPS (the Italian Social Security) unemployment benefits in order to finance the rent or sale of a company (by exercising the legal right of co-operatives formed of workers from the same company in financial difficulty to rent or sell as specified in the bankruptcy proceedings introduced by the same law).

There are therefore a number of reasons why the Italian co-operative system can rely on mutual venture capital which, by using only resources self-generated by the co-operatives, can stimulate healthy competition between non-profit organizations to finance worthy ideas and projects and, last but not least, recover and re-launch business ventures, including profitable ones, which are in financial crisis.

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