# THE RELATIVE POSITIONING OF COMMERCIAL BANKS AND INVESTMENT BANKS IN THE ITALIAN CORPORATE FINANCE INDUSTRY. AN EMPIRICAL ANALYSIS.

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# The Relative Positioning of Commercial Banks and Investment Banks in the Italian Corporate Finance Industry. An Empirical Analysis.

Vincenzo Capizzi

## Abstract

The aim of the study is to analyze the Italian market of corporate finance services from the supply side, showing the characteristics of those intermediaries able to obtain the highest profits from this kind of services as well as pointing out potential available spaces in this market for domestic actors, either investment banks or commercial banks. The main verified hypothesis is the higher ability of commercial banks with respect to investment banks in the supply of advisory services instrumental to corporate finance operations. Results of the empirical analysis support the hypothesis that the commercial banks are operators particularly capable of running corporate finance activities, at least in the domestic context, where the demand is mainly coming from small and medium size firms and is typically focused towards customized services aimed at successfully implementing ownership structure reconfigurations, such as leveraged acquisitions and turnarounds of distressed firms. Furthermore, the market's demand side seems to particularly appreciate the synergic potential stemming from the combination of lending and corporate finance activities, rather than the higher expertise and reputation gained over time by investment banks in the analysed industry, which, in turn, generally means higher unit prices. Finally, thanks to, from one side, synergies coming from lending activities and, from the other side, the outsourcing of those phases of the production process that are not economically convenient to develop internally, domestic banks and banking groups tend to utilize "lighter" structures – that is with a lower incidence of fixed costs over the total operating expenses – than investment banks do for their corporate finance activities. For these reasons, national actors are able to operate in the Italian corporate finance industry with internal structures characterized with more cost efficiency and lower operational risk, with related advantages in terms of both profitability and competitive positioning.

# THE RELATIVE POSITIONING OF COMMERCIAL BANKS AND INVESTMENT BANKS IN THE ITALIAN CORPORATE FINANCE INDUSTRY. AN EMPIRICAL ANALYSIS.



## 1. Introduction.

As well known, the investment banking's business area commonly labeled *corporate finance* (or *market for corporate finance services*) covers a wide range of products and services designed to support companies in the implementation of their financing policies.[1] In other words, the intermediaries operating in this specific business area, acting primarily as advisors, receive the mandate to design and undertake different plans and actions in order to try to help their corporate clients to face with complex needs, either from a strategic or from a financial standpoint, which are not usually related to their day by day operating activity. Some of the major mandates involve the bank advisory activity in order to favour: a growth strategy through mergers and acquisitions (M&A); a downsizing strategy, through spin offs and split offs, aimed at focusing the company activity on specific business area; the realization of a strategic alliance through reciprocals exchanges of equitystakes; the design of a turnaround plan in order to restructure distressed companies.

In Italy, furthermore, the range of strategic and financial problems that firms have to face with is still wider, due to the specificities of the domestis entrepreneurial system, largely grounded on the massive presence of small and middle size enterprises, most of all owned and managed at a family level.[2]

More concretely, apart from the most traditional and demanded services of financial advisory such as those above mentioned, there are other services particularly relevant in the national context; among them, it is important to make reference to the so-called *leveraged acquisitions* (in particular, *management buy-outs and family buy-outs*), aimed at managing intergenerational succession problems of the client firm, or the supply of financial advisory in order to help firms to reduce their vulnerability, which, most of all, is the result of disequilibrated financing policies, leading, ultimately, at balance sheets characterized with high debt/equity ratios and, moreover, with dramatic predominance of short-term debt capital.

The aim of this paper is to analyze the market for corporate finance services from the supply side, showing the characteristics of those intermediaries able to obtain the highest profits from this kind of services as well as pointing out potential available spaces in this market for domestic actors, either investment banks or commercial banks.

[1] See Kuhn (1990), Nardozzi, Verna (1996), Liaw (1999), Forestieri (2003a), Capizzi (2003a), for extensive descriptions of the investment banking industry.
[2] See Storey (1994), Corbetta (1995), Raffa, Zollo (1998), Furesi, Minoja, Zattoni (1999).

The main verified hypothesis is the higher ability of commercial banks with respect to investment banks in the supply of advisory activity aimed at implementing corporate finance operations in the Italian context.

In other words, when commercial banks receive a mandate to support a corporate transaction or whatever corporate finance operation, they can rely on a critical success factor: their long time lasting credit relationship with the client firm, which provides a wide and unique set of information about the company characteristics and objectives. This kind of factor is relevant in a context where average firm has small dimensions, is mostly owned and managed by family groups and is not highly transparent, at least when compared with bigger and listed firms. Naturally, when dimensions and complexity of an operation increase, the information opaqueness about the client firm decrease, and, ate the same time, other factors become relevant for the advisor. These are first of all reputational capital, expertise and relational network that the advisor can rely on. In these aspects, investment banks are normally in a privililedged position with respect to commercial banks.

In fact, the empirical analysis performed through questionnaires sent to a selected and representative sample of commercial and investment banks, reveals a "natural" segmentation of the market. It first shows the capacity of the domestic commercial banks to successfully handle small size operations, as they can rely on especially their territorial penetration generated by their traditional deposit-taking and lending activities and thereby their higher capacity in keeping close relationships with Italian SMEs and satisfying their complex financial needs. The role of major domestic and foreign investment banks becomes more prevalent in big deals where having reputation and know-how is more crucial to their succesfull closing.

Before describing in details all the results of the empirical analysis, it is worth underlying that the results provide some elements that would support the hypothesis that commercial banks are financial operators particularly capable of running corporate finance activities, at least in the national context where the demand is mainly coming from small and medium size firms and is typically focused towards customized services required to successfully implement capital structure reconfigurations, such as leveraged acquisitions and turnarounds of distressed firms. Furthermore, the market’s demand side seems to particularly appreciate the synergic potential stemming from the combination of lending and corporate finance activities, rather than the higher expertise and reputation gained over time by investment banks in the analysed business area. Finally, thanks to, from one side, synergies coming from lending activities and, from the other side, the outsourcing of those phases of the production process that are not economically convenient to develop internally, domestic banks and banking groups tend to utilize “lighter” structures than investment banks do for their corporate finance activities. For these reasons, national actors are able to operate in the Italian corporate finance industry with internal structures characterized with more cost efficiency and less operational risk, with related advantages in terms of both profitability and competitive positioning.

The rest of the paper is organized as follow: the next section presents a literature review in order to identify the major theoretical rationales behind the existence of intermediaries in supplying professional advisory services to support corporate finance operations. Section 3 depicts the typical production process of an advisor involved in a corporate finance transaction, in order to show the major competencies and the critical success factors required to be competitive in the analysed business area of investment banking. Section 4 present first the methodology of the empirical analysis conducted, and then proceeds to the interpretation of data and information coming from the empirical analysis, while section 5 discusses the main conclusions and open questions, also giving suggestions for future research.

## 2. Theoretical rationales for the existence of financial intermediation in the corporate finance industry.

Even if not as wide as the literature which has theoretically and empirically analyzed the role played by financial intermediaries in the business area of capital markets services,[3] there is, especially starting from the 1980s, a growing literature dealing with the study of the specificities of the professional contribution given by financial intermediaries when acting as advisors in order to support corporate finance transactions.

In particular, a first stream of contributions – surely the widest one – has focused on the distinctive role played by advisors in the analysed business area, without taking into consideration the nature of *commercial* or *investment* bank of the advisors themselves involved in a given operation. As we will see, in many cases the nature of the advisor (commercial or investment bank) may imply possession of different competencies or professionalities that, in turn, can significantly affect the success of a given operation.

Continuing with the above mentioned stream of contributions, one major class of explanations for the existence of financial intermediation in the area of corporate finance services refer to the intermediaries' capability to significantly reduce transaction costs in the reallocation of companies' ownership. Among others, fundamental contributions of Gurley and Shaw (1960), Benston and Smith (1976), and Fama (1980) have already shown the relevance of the role of internediaries that, thanks to their professionality, *know-how* and "production technology", are capable of matching the preferences of counterparties engaged in a transaction regarding financial contracts[4]. More concretely, when these contracts deal with the negotiation of companies' majority equitystakes, the contribution of the *advisor* is above all consisted of its capacity to search for counterparts, to make necessary and sound valuations in order to determine the price, and to conduct the negotiation phase with a minimum cost for the single firms engaged in a given transaction[5].

According to a second group of explanations, directly coming from transaction costs' literature, financial intermediaries play an essential role in the market of corporate finance services due to their higher ability to collect, produce and manage relevant information about diverging interests of the counterparties involved in a given transaction. This argument was dramatically exploited starting from the 1970s, giving rise to a number of studies and contributions about the role of information asymetry in the financial systems.[6] Applying the

[3] See Smith (1986), Ritter (2003) and Previtero (2004) for comprehensive literature reviews.
[4] For a wide review of the most relevant contributions in the financial intermediation theory, see Santomero (1984), Chan, Greenbaum, Thakor (1986), Hellwig (1991), Bhattarcharya, Thakor (1993), Forestieri (1993), Freixas, Rochet (1997), Allen, Santomero (1997, 1999).
[5] See Liaw (1999) and Capizzi (2003b, d) for a detailed analysis of the production process of the intermediary involved in an M&A transaction as an advisor.
[6] See note 4.

information asymmetry arguments to the investment banking industry, Servaes and Zenner (1996) demonstrate that the corporate need for the intervention of an advisor is positively correlated with the complexity of a given M&A transaction. The complexity may refer to the small dimension and opaque information of the target firm, the diversity of the industries in which the buyers and the sellers operate, the diversification potential of the target firm. Other sources of complexity are derived from corporate governance models of the target firm or from the fact that the negotiation deals with one single business area of the target firm.

A third group of explanations, again making reference to information asymmetry litarature, justifies the existence of advisors in corporate finance operations not only on the basis of their relative efficiency in gathering and elaborating information, but also on the basis of their "certification" effect, due to their reputation, which guarantee the successful closing of a given transaction. Bowers and Miller (1990) analyzed the stock returns of a large sample of firms that had made acquisitions, finding that the ones having applied to financial intermediaries' advisory services in their transactions have obtained higher increases in their equity values. Similarly, Hunter and Walker (1990) have found evidences suggesting the existence of a direct relationship between benefits of merger processes and the commissions earned by the investment banks for the advisory role played in the deal. Naturally, it is necessary to be a bit cautious in interpreting such results, given that, as stated by McLaughlin (1990, 1992), some incentives that characterize the advisor's remuneration schemes (for example, the presence of a “success fee”) can create conflict of interests between the investment banks and its client during an M&A transaction.

A fourth group of explanations puts the problem in a multiperiodal bank-firm relationship context. More specifically, Srinvasan (1999) has shown that the commissions paid by a given firm for advisory services instrumental to an M&A transaction include generally some sort of a "relationship premium", had the bank already supplied advisory services to that single firm in previous corporate finance operations. A similar premium may imply either that it is costly for the firm to change advisor when it has to implement many acquisitions over time, or that a long term relationship with an advisor brings some benefits like, for example, a better and more complete consultancy service or, again, a “certification” effect which is not due to the reputational capital of the advisor, as in the prvious case, but to the possibility of collecting private information from the client firm thanks to the existing long term relationship. Besides, Rau (2000) provides some empirical evidence that seem to demonstrate that also reputation and expertise are important factors to be considered in such a context of multiperiodal bank-firm relationships. In other words, there could be a direct relation between success rate of a given M&A transaction and the “quality” of an intermediary involved: the best advisors (“*top-tier investment banks*”), those with highest market capitalization and highest commissions charged to their *corporate* customers, generate value by increasing the probability that a given transaction is successfully concluded. Finally, Saunders and Srinivasan (2001), on the basis of an empirical analysis conducted with a sample of more than 800 M&A operations in the U.S. market between 1979-1998, find that the acquiring firms pay higher advisory fees to intermediaries with which they have a previous advisory relationship. The authors also show that these higher remunerations do not necessarily create value for the acquiring firms when they make announcements to the market about the choice of the advisor. The argument of the authors is not surprising: the firms are more disposed to change advisor when they do not need best intermediaries, turning instead to operators with less reputation than well-known *top-tier investment banks*.

As it was mentioned at the beginning of the section, the contributions that we have seen up to now take into consideration only the advisory role played by financial institutions in M&A transactions. A more recent stream of research has tried to take into consideration also the nature of the intermediary chosen as advisor, in order to verify if there are competitive advantages that could favour, respectively, commercial banks or investment banks in the corporate finance industry.[7] In parallel with a great number of contributions[8] that have empirically verified, with negative results however, whether commercial banks could be exposed at potential conflict of interests when operating as dealers or underwriters in the capital markets,[9] another group of studies have exclusively focused on the advisory role played by commercial banks in the corporate finance industry.[10]

Allen, Jagtiani, Peristiani and Saunders (2001, 2004), for example, hypothesize that the certification effect generated by commercial banks when acting as advisors is superior than that coming from investment banks. The reason is that a commercial bank that is chosen as an advisor for an M&A transaction can rely on its existing credit relationships. A Continous and lasting relationship over time gives the bank an opportunity to collect, elaborate and utilize private information about the client on an ongoing basis. An empirical analysis conducted with a sample of 500 *deals* in the U.S. in 1995-2000 period seems to confirm a similar hypothesis. It shows that also in the presence of potential conflict of interests – that arises when the bank adjuncts also advisory services to its lending services in its contractual relationships with its existing corporate clients – the increase in the stock value of the target firms giving advisory mandates to their own commercial banks is significantly higher than that obtained by the target firms that choose an investment bank or a commercial bank with which they have no sort of previous relationship. Besides, analysis of the authors show that when the same banks operate also as advisors, by running this activity they have benefits in terms of increase in their value and reputation, even if only when they operate as advisor of the target firms and not of the acquiring firms. That is to say, the market particularly appreciate the role played by commercial banks in the corporate finance industry when, through their private information generated during their lending relationships, they are able to favour transactions involving companies with small size, little separation between ownership and control and, most important, low aptitude to disclose information to the market.

[7] Infact, only in recent years the normative barriers that prohibited *commercial banks* to have access to certain specific business area of the *investment banking* services have been progressively eliminated in most domestic financial systems. Now commercial banks have, almost all around the world, access to *capital markets*, *merchant banking*, *corporate finance* advisory services. For example, in Italy when became effective in 1994 the new Bank Company Act (the so-called “Testo Unico delle Leggi in materia Bancaria e Creditizia”), the banks were allowed, among other options, to enlarge their activities to brokerage, dealing, underwriting, financial advisory and asset management. In the Unites States, the "Glass Steagal Act", which for decades separeted the commercial and investment banking activities, was substituted only in 1999 with the introduction of the “Financial Services Modernization Act”.

[8] See Kroszner and Rajan (1994), Ang and Richardson (1994), Puri (1994, 1996, 1999), Hebb (1999), and Ritter (2003) for a complete discussion about the topic.

[9] The reason for this potential conflict of interest is that capital raised through a securities’ issue could be used by low rated companies to reduce the bank dealers’ default risk and, eventually, to cover some bank loans coming to maturiry. Another source of potential conflict of interests is due to the fact that the bank may not want to reveal the market the real financial situation of the advised firm in order to maximize the probability of positive conclusion of a given security placement.

[10] Another interesting stream pioneered by Laux (2001) – that does not enter in the scope of this present volume – has analyzed the role of the intermediaries that offer legal *adisory* services in the M&A market.

In a following extension of this work, Allen and Peristiani (2004) show that the market does not seem to give value to those transactions where the acquiring firms' advisors are at the same time their lending banks, given that the stock returns of these firms significantly decrease after the deals. One explanation lies in the fact that the advisor does not need to determine the value of its client firm by exploiting its available private information. Another explanation is that there is a strong incentive for the bank to promise to continue its future lending activity toward the acquiring firm in change for obtaining the mandate by the firm itself. The authors even analyze the pricing of loans given by the acquiring firm's advisor bank following the acquisition, showing the presence of concrete incentives for the bank to negotiate future financing facilities with interest rates well below market rates, in order to obtain commissions coming from the advisory activity in an M&A transaction.

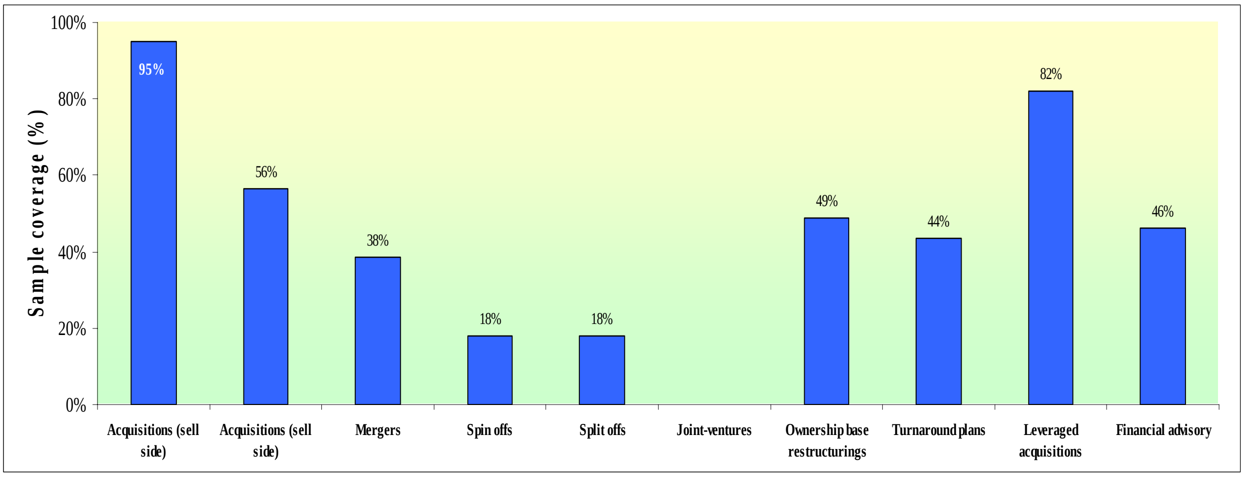
This work is consistent with the last stream of contributions above described. It is aimed at deeply analysing the market of advisory services in the Italian corporate finance industry, in order to identify both strategic requirements and critical success factors necessary to financial institutions desiring to gain and maintain competitiveness and profitability in this business area.

In particular, while there should be no doubt about the relevant role played by the existence of long term bank-firm relationships, notwithstanding the nature of advisor itself (commercial or investment bank), it seems crucial to verify whether commercial banks enjoy a sustainable competitive advantage over investment banks and other financial institutions, due to their consolidated networks of long term relationships with domestic small and medium-size enterprises, that is to say with the heart of the Italian entrepreneurial system. This argument also explains why it could be rational for small-size commercial banks, with a limited geographical scope, to stay in the market, whenever benefits coming from, respectively, territorial penetration, deep knowledge of local firms and lasting lending relationships exceeds the costs represented by their lower reputation and expertise than those characterizing top-tier financial institutions.

At the end of this section, it is worth saying that this work makes reference to a different and somewhat wider notion of corporate finance industry than that characterizing the majority of the above mentioned theoretical contributions. In fact, the last ones essentially concentrate on *advisory* services offered in order to support M&A transactions. In this paper, as specified in the introductory paragraph, reference is made to a broader perspective, according to which belong to the corporate finance industry all those products and services supplied to firms in order to solve complex financial problems, that is far different from those related with ordinary day-by-day operativity. For this reason, such a perspective, on the one hand, it inevitably introduces methodological problems given that, generally, statistics and market data needed in order to verify the validity of the assumed propositions cover most of all M&A transactions, that is those operations concluded with an ownership change; on the other hand, however, it is allows to shed light on a business area very relevant in terms both of resources employed and profits generated, thanks also to a number of advisoroy services offered to meet corporate financial needs that do not neecssairly require however, a change in ownership.

In this respect, figure 1 shows that, among the advisory services offered by the selected sample of financial institutions resulting from the empirical analysis, are particularly relevant advisory services instrumental to the finalization of *leveraged buy-outs:* the 82% of the answering financial institutions claims to offer this service. Not surprisingly, assistance aimed at facilitating the realization of spin-offs, mergers and acquisitions – especially the supply of advisory services on the sell-side – are highly demanded as well by corporate clients. Moreover, financial consultancy and restructuring services to distressed companies are offered by almost half of the sample, representing other relevant typologies of products in the Italian.[11]

**Figure 1. – Operations and services of *corporate finance* offered by intermediaries in the sample**




*Source: Sample DIR_Investment Banking SDA Bocconi (2004)*

## 3. The market for corporate finance services in Italy: the specificities of both demand and supply side

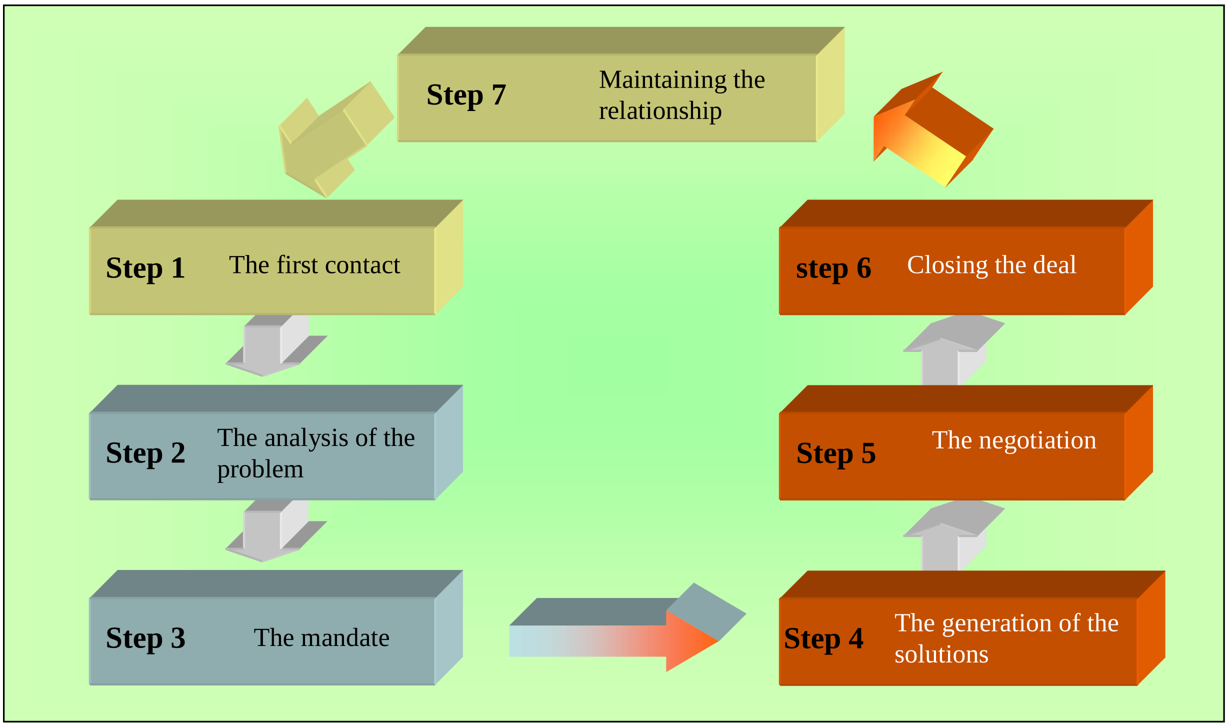
As shown in the conclusion of the previous section, obtaining an advisory mandate in the business area of corporate finance services can foresee a wide and heterogeneous range of activities and operations to be realized by the financial intermediary. It is remarkable that the only common element with these interventions is the consultancy nature that characterizes the advisory operativity. In other word, it isIt supposes a fix contractual relation with the client firm in which *problem solving c*apacity of the intermediary becomes a critical point.

To go deeper in detail, it is possible, making reference to the empirical observation of real behaviors and actions undertaken by financial intermediaries, to decompose in different steps the production process of an advisor involved in a given corporate finance operationn The disintegrated phases (see figure 2).[12] Such an effort allow to evidence, consistently however with the arguments presented throughout the literature review, that the critical success factor more than once labeled as "problem solving" can be fully exploited and valued when the necessary costs for gathering and analyzing private information from the client firm are minimized, as well as the costs necessary to negotiate and implement the identified

[11] For a detailed description about *corporate finance* product and services, see Forestieri (2000), Capizzi (2003c), and Caselli, Gatti (2003).
[12] *See* Capizzi (2003b).

solution. So, it is absolutely justified the presence of banks and investment banks in the market because, thanks to their possibility to rely on, respectively, their long-term relationships with the client firm, their reputational capital, and technical and relational competencies, they are capable of satisfying the financial needs of the corporate clients efficiently and effectively.

**Figure 2. – The production process of an *advisor* in a *corporate finance* operation**




*Source: Elaboration of the author*

Even if, as it can be easily imagined, there are many corporate finance services that firms can demand to financial intermediaries, at this point, we need to shed light over the production process undertaken by an intermediary receiving a mandate to support as an advisor a given M&A transaction. This is the most demanded typology of interventions in the analysed business area, and the most monitored as well: as anticipated, only for M&A transactions are usually available enough complete and reliable data, so to be able to perform robust analysis regarding their volumes and growth trends in the major financial systems all around the world.

Typically an M&A operation is the result of a quite complex negotiation process taking place between two categories of subjects (buyers and sellers) that are characterized by conflicting goals and needs. Both of the parties are potential clients for commercial and investment banks, as they need professional figures capable of finalizing a given transaction. Obviously, due to the prevailing remuneration schemes, while the seller's advisor has strong incentives to reach a closing price that maximize the firm equity value, the buyer's advisor will act in the opposite direction, trying to decrease the necessary payment to a minimum to ensure the control of its client. Furthermore, it is hardly worth underlining that the negotiation between the counterparties – and their associated advisors – makes reference not only to monetary issues of a given transaction, but also to other crucial issues dealing – among the others – with the capital structure, the ownership base and the competitive strategy of the new entity generated after the transaction itself. This makes it even harder the advisors' work.

In any case, the bank offering advisory services in M&A transactions goes through a production process with clear-cut phases (or steps) that can be decomposed and analysed following a logical and temporal order, this time in a more precise manner than the previous one with reference to the advisory instrumental to a generic corporate finance operation (see figure 3).[13] Through such a research approach it is possible not only to clearly distinguish the different actions undertaken by the advisor while carrying out its job, but also to identify the typology of resources, knowledges and competencies, as well as necessary investments required for each identified phase.

In this respect, different phases in figure 3 can be regrouped in three macro categories relatively homogenous within each other:

a. "upstream" phases of the production process;

b. "downstream" phases of the production process;

c. "staff" phases of the production process.

The first group include the phases 2 ("The mandate"), 3 ("The stand alone valuation"), 4 ("The definition of the sale strategy") and 5 ("The market analysis"). In these phases, positioned as "upstream" in the productive process, advisory activities require specific investments especially in "human capital"; among these, it is worth underlininig the research aimed at performing industry analysis, or discounted cash flow analysis, or sensitivity analysis; other investments deal with the time employed by senior professionals in order to design comples solutions consistent with the different obiectives of the counterparties involved (in terms of transaction price, terms of payment, tax issues, etc.).

The second group essentially include "downstream" phases in the production process, such as 6 ("The confidentiality agreement"), 7 ("The selling memorandum"), 8 ("The negotiation"), 9 ("The Due Diligence") and 10 ("Closing the deal"). In this case, the production process imply the possession of:

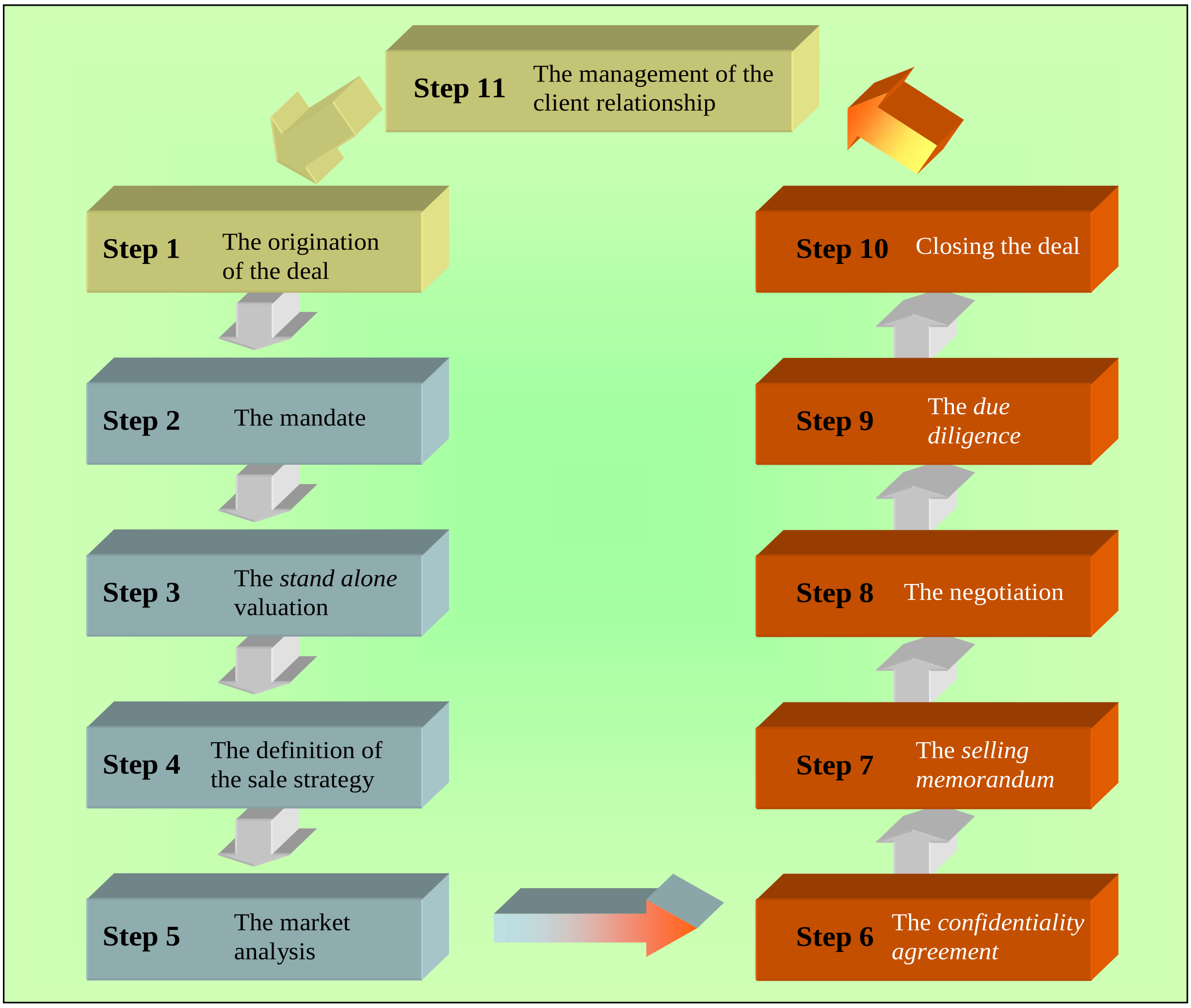
1. *know-how*, referring to either operational procedures (for example, the procedure needed to approach potential investors and their *advisors*, or to conduct negotiations) or technical issues characterizing an M&A operation (for example, the finalization of either the confidentiality agreement or the ***selling*** *mem*orandum);
2. *placing power*, that is a huge number of contacts and relationships (with potential client firms), that is fundamental to operate in the analysed industry on a continuing basis;
3. *relationship* networks with other professionals, that have competencies (especially accounting, legal and fiscal) that are not economically convenient to internalize but, in any case, are necessary in the closing phase of a given transaction.

[13] Figure 3 evidences the production process implemented by intermediaries when acting as advisor in a given M&A transaction from the point of view of only one of the counterparties involved, and, in particular, assumes the prospective of the advisor who receive the mandate from the seller (sell side). It is worth saying that, nothing else changed, majority of the phases in which intervention of the financial intermediary is split up describe also the operativity of intermediaries advisoring the buyer (buy side). For a deep analysis of the content of the activities performed by banks in each phase, see Capizzi (2003d).

As it can be noticed, this grouop has in itself a series of value creating activities that principally require high resources and relational competencies. These production factors, if absent, cannot be developed internally, at least in the short term, but can be obtained over time and are also sustained by the increasing number of deal closed. Once they are developed, they enhance the reputational capital of the intermediary; a higher reputation, in turn, increase the capabilityto obtain new mandates on a continuing basis.

The third group is consisted of phase 1 (“The contact") and 11 (“The management of the client relationship"), that involve the activities strictly needed in order to initiate the advisory process, but do not explicitly generate remuneration for the intermediary, absorbing however "physical" and, most of all, "human" capital: for example, the opportunity-cost represented by the time employed by senor professional to create and manage relation with their potential clients' "portfolios". The investments made to manage and create contacts should be considered as necessary sunk costs to develop the analysed business area. In this sense, the capability of a bank to maintain alive those contacts generated in a successfully closed M&A transaction (phase 11) can be seen as a predetermined strategic choice aimed at controlling a distribution channel, so to increases the probability of receiving future advisory mandates.

**Figure 3. – Production process of *advisor* in an M&A operation**




*Source: Elaboration of the author*

Naturally, such a decomposition of the phases of the production process of intermediaries involved as advisors in a M&A transaction cannot be extended to each kind of operation referrable to the corporate finance industry, being the output of a generalization process starting from an indepth analysis of some specific transactions . In reality, each M&A operation is different than the other and presents peculiar characteristics and solutions that are difficult to structure and rationalize in a theoretical framework.[14]

Besides, as we will see in section 4, it should be kept in mind that even if the services related with M&A operations– including the valuation of the target firm, the due diligence, fiscal and legal advisory, and (eventually) the fundraising of the deal – in general terms can be supplied by one reference financial institution, the common practice, both at national and international levels, seem to prove existence of "connections" that are more or less stable between various groups of institutions and professionals (academics, consulting firms, commercial banks, *merchant banks*, *business banking*, audit firms) specialized in different complementary activities with favorable results in a given transaction.

By now, we have presented all those elements related with the corporate finance industry that are necessary to be able to proceed to interpretation of the results of the empirical analysis performed, which is deeply discussed in the following section. In line with the above mentioned research questions, it aims at identifying the relevance of different phases od the production process undertaken by intermediaries – both commercial banks and investment banks – in the analysed industry and showing the critical factors required to compete successfully in this business area.

## 4. The empirical analysis: methodology and results

As it was already anticipated, differently than the empirical analyses most commonly performed by the relevant literature which was reviewed in section 3, in this paper we draw our conclusions by elaborating the results coming from the answers received to a questionnaire that was sent to a sample of banks, selected in a way to be highly representative of the *investment banking* industry in Italy.[15] Even if the redemption rate (37,7%) is high enough to confirm the validity and robustness of the study, however, methodological[16] limitations of the analysis should always be kept in mind. The specific methodology used present, first, advantage to allow to take into consideration previously unexplored qualitative elements dealing with both the business model of the advisors, and, more in general, the

[14] In other words, non all operations follow completely this scheme: some phases may miss or be integrated or follow a different order. So, for example, the *stand alone* valuation should not necessarily follow the receipt of the mandate, but may constitute a sort of "marketing" strategy utilized by the *advisor* to create demand for advisory services. Besides, it is not rare, for example, that the selling memorandum starts from the earlier phases. Another point that should be mentioned is that some firms have the capacity and resource to develop "M&A teams" internally. These teams are composed of specialists and capable of handling some phases (for example, the valuation, the selling memorandum, the market analysis and the selection of potential buyers), reducing the scope of the advisory activity required to the *investment bank*: in this case there is an "autoproduction" of M&A services by the firms themselves.

[15] See Capizzi (forthcoming) for more details about the methodology used for the empirical analysis; here we are only referring to a section of the empirical analysis as a whole, that dealing with the business area of corporate finance services.

[16] See note 15.

competitive dynamic characterising the analysed industry. Second, the questionnaire-based methodology made it possible to extend the analysis to a wider range o*f corporate finance* services than those usually considered by literature, that is advisory services independent on M&A transactions.

In the following section, after a brief description of the main methodological issues behind the empirical analysis performed (§ 4.1.) and of the major sample's qualitative and quantitative characteristics (§ 4.2.), we will proceed to the discussion of the main results emerging from the questionnaire that the research team arrived at. Following profiles of the analysis will be separately taken into consideration: the size and the growth trend of the corporate finance industry (§ 4.3.); the characteristics of the advisor's production process (§ 4.4.); the profitability of analysed business area (§ 4.5.).

## 4.1. Data and Methodology

The present paper draws its conclusions basing upon a database generated through an articulated questionnaire that has been supplied to a sample of financial intermediaries, built in a way to be significatively representative of the Italian market for corporate finance services. From one side, drawbacks and bias affecting such a research methodology are well known;[17] one needs only think to the existing incentives to give representations different from reality, or to give answers influenced by the common opinion about a given topic, or, again, to choose median values inside the range of values associated to a given question. Furthermore, it should be considered the low rates of redemptions generally characterising questionnaire-based surveys. From the other side, however, given the scarcity of publicly available source of information regarding corporate finance operations in the Italian market and given the wider notion of corporate finance at the heart of the present research, it has been considered advantageous the access to a methodology that: a) allows the researcher to identify qualitative as well as quantitative attributes characterising a given investigated population; b) can produce stable and reproducible measure, with obvious benefits to the validity of the empirical analysis; c) implies rather low costs and execution times, at least when compared to other methodologies; d) allow a quantitative analysis of the information gathered.

The questionnaire realised consists of different sections: the first one is aimed at obtaining, first of all, general data and information about the respondent institutions and, second, at investigating the most typical financial needs of Italian fims and, hence, investment banking services, as perceived by the reference sample of banks. Each of the following sections deal with a specific investment banking's business area: "Corporate Finance" – the only one whose results are examined and elaborated in this contribution – "Project Financing", "Capital Markets", "Merchant Banking", and "Risk Management".

Each of these latter sections is structured in an homogeneous way, making reference to three specific groups of questions. The first group is aimed at gathering information about the volume and the growth rate of the activity performed by the answering intermediaries in each business area. The second group of questions try to obtain data dealing with strategy,

[17] See Bailey (1995).

organization and production process of the analysed financial institutions. The final group of questions focus on the economics of the activities related to investment banking industry, in order to identify its major sources of profits.

In the annex at the end of the paper is presented the questionnaire-form sent to the selected banks, though limited to the "General Information" and "Corporate Finance" sections.

The questionnaire, before start sending it to the reference sample, was tested by subministrating it to some key informants, so to undertake a fine tuning procedure aimed at improving the information potential coming from the questionnaire itself.

The sample of financial institutions to be investigated was built by making reference to a mix of different criteria, in order, on one hand, to identify a wide number of intermediaries and, hence, provide the empirical analysis with the necessary requirements in terms of both stability and reliability. On the other hand, the goal was to focus the empirical analysis only to subjects significantly operating in the investment banking industry and, furthermore, to exclude, at lest initially, consultancy firms, professional partnerships and, more in general, all those advisor operating in some business areas of the investment banking industry, but different from financial intermediaries. These last operators, not subject to Regulation by Public Authorities, operating with different ownership, organisational structures, business models and information disclosure requirements, are not included neither in the research scope of this contribution nor in that characterising the previously reviewed stream of literature.

More in detail, we started selecting the first 100 Italian banks ranked on the basis of the average service charges and fees generated in the 5-year period 1997-2002. We chose such an accounting item, rather than other traditional segmentation parameters (like, for example, the banks' total assets or number of branches and subsidiaries), because it generally includes the major part of the revenues originating from the operativity in the investment banking industry. [18]In order to avoid distorsions coming from a few big size operations, reference was made to average data calculated over a 5-year time period. The database used for the accounting item was extracted from the "Annuario delle Banche", annually updated by DP Analisi Finanziaria, Grant Thornton S.p.A. and MilanoFinanza.

From the selected group of banks were excluded those not consistent with two of the four criteria below evidenced, aimed at checking their operativity in each of the investment banking's business areas.

- The first criterium consisted in controllino the presence of each banks in the official list of the intermediaries authorised to supply capital market services (securities underwriting, selling, dealing and brokerage; asset management; securities custody). This list is periodically updated by Borsa Italiana S.p.A., the owner-manager of Italian Stock Exchange.
- The second criterium takes into account whether each selected intermediary joined or not "AIFI", the association of those institutional investors performing on a professional basis merchant banking activity. Obviouslly, a bank meet such a criterium even if the affiliation refers to one of its parent companies.

[18] See Nardozzi, Verna (1996); Capizzi (2004).

- The third criterium required to verify whether the selected banks appeared as advisors supporting corporate finance or project finance operations that were published by economic newspapers (like, for example, Il Sole 24Ore and MilanoFinanza), conference press or other source of public information.
- As a final criterium, it was calculate the median value associated to the volume of derivatives contracts, as resulting from accounting data, traded on average during the reference period by the selected banks; this benchmark value was then compared with that calculated for each single banks, so to have a rough idea of their operativity in the risk management industry

After this screening process, it was conducted a new investigation in order to verify whether from the sample had not been being considered banks or financial companies operating in the domestic investment banking industry, but not belonging to the group of intermediaries originally considered. The banks emerging from this research were included in the sample. Then, we added all those subjects originally excluded because not being banks or financial intermediaries, but resulting to be very relevant actors in some specific investment banking's business area. This procedure allowed to consider some relevant operators in the corporate finance business, that, as we will see, is mostly characterised by an intrinsic advisory nature and not necessarily imply funding the corporate clients. As regards this we made reference: a) to the above mentioned sources of information; b) to the rankings periodically produced by specialised information providers (like Thompson Financial and Mergerstat), with breakdown by business area or geographical scope; c) to the major research centres operating in the Italian context that periodically monitor transactions, operations, intermediaries in the major investment banking's business areas (AIFI for venture capital and private equity, Bocconi University, KPMG, Dealogic for M&A transactions, Banca d'Italia, CONSOB, Assogestioni for capital market services).

We thus obtained a group composed of 86 domestic operators, distinguished between commercial banks and investment banks; the latter including also a few nonbank financial institutions.

Finally, by getting access to the sources of information just mentioned, we introduced in the sample those foreign financial institutions – and among them the so-called "top-tier investment banks" – resulting to be massively involved in the Italian investment banking industry. This added 36 more subjects to the reference sample, 20 of which represented by commercial banks – or, better able to be described as global banks, given their extremely diversified business model and geographical scope as well – an the others being investment banks.

It is worth underlining that the inclusion of the foreign intermediaries, on one side, is cause of a lower homogeneity in the sample, most of all in terms of number and volume of deals advised; on the other hand, however, we must keep always in mind that one of the goals of the present contribution is to identify key success factors and strategic-organizational requirements needed to successfully compete in the analysed industry. In this sense, it was crucial to build a sample including the best operators, domestic as well as foreign, so to be able to enucleate existing best practices. In any case, the results presented in the section next sessions will keep separate as much as possible domestic advisors from foreign advisors – and, inside each category, commercial banks from investment banks as well.

The final sample was composed of 122 banks and financial institutions, perceived as highly representative of the real number of operators acting as advisors in the Italian investment banking industry.[19]

The questionnaire previously described was thensubmitted to the Headquarters of the reference intermediaries or to the Direction of the Corporate Banking Department, which is, inside the bank, the organisational unit specifically dedcited to the operativity in the investment banking industry.

## 4.2. Sample's qualitative and quantitative characteristics

At the expiration of the scheduled deadline for the submission of the fulfilled questionnaire-form, the answers were 46, equivalent to a redemption rate of around 38%. It was the created the so-called "DIR_Investment Banking Sample", whose characteristics will be investigated in section 5.

As regards this, table 1 offer a full picture about both the qualitative and quantitative composition of the DIR_Investment Banking Sample, as emerging from answering banks' profiles.

**Table 1. – Composition of the analysed sample**

| | Typology of intermediary | | | | Nationality | |
|---|---|---|---|---|---|---|
| | *Investment banks* | *Global banks* | Domestic Commercial Banks | Domestic Investment Banks | Domestic | Foreign |
| **Redemption** | 38% | 20% | 38% | 44% | 42% | 28% |

*Fonte: elaborazione dell'autore su Campione DIR_Investment Banking SDA Bocconi (2004)*

It is interesting to note from table 1 the high redemption coming from that category of subjects – domestic commercial banks – characterised by high levels of diversification, where in many cases investment banking operativity is not the major one.

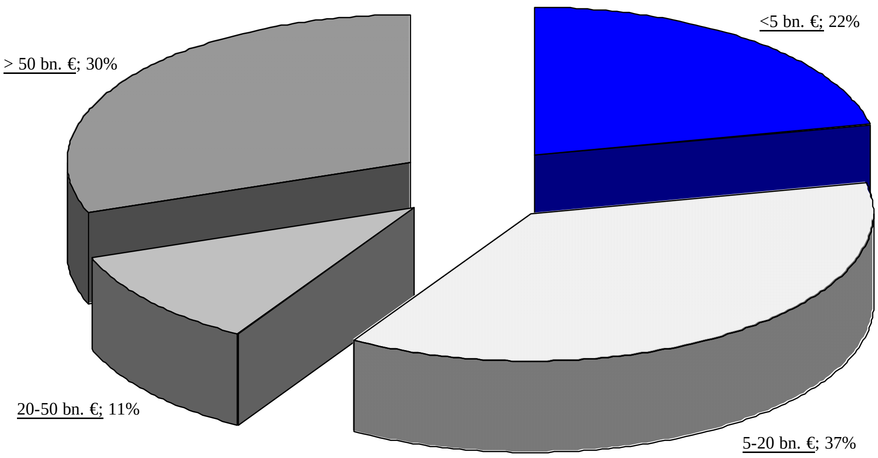
Furthermore, if we take into account the 46 answering subjects, the 54,3% is represented by domestic commercial banks, followed by domestic investment banks (23,9%) and foreign investment banks (13,0%). Last, we find foreign commercial bank, that is global banks (8,7%).

If we look at the size of the reference banks belonging to the analysed sample, we can observe that almost the 60% is represented by small sized financial institutions, that is banks with total assets lower then 20 billion euro, whereas about the 30% consists of intermediaries with total assets higher than 50 billion euro (see figure 4). It remains rather under-represented the category of medium sized banks, with typical infra-national geographical scope, that seem to be crowded out, given that, on one side, they don't get those benefits (most of all in terms of dealflow origination) coming from widespread territorial coverage which are available to smaller banks in their reference arenas (regional and sub-regional), and, on the other side,

[19] In the annex is presented the complete composition of the final sample used for the empirical analysis.

they can't rely on both know how and reputational capital generally characterising bigger intermediaries, with national and international focus.

**Figure 4. – Breakdown of the sample by size of intermediary** *(total assets; billion euro)*




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

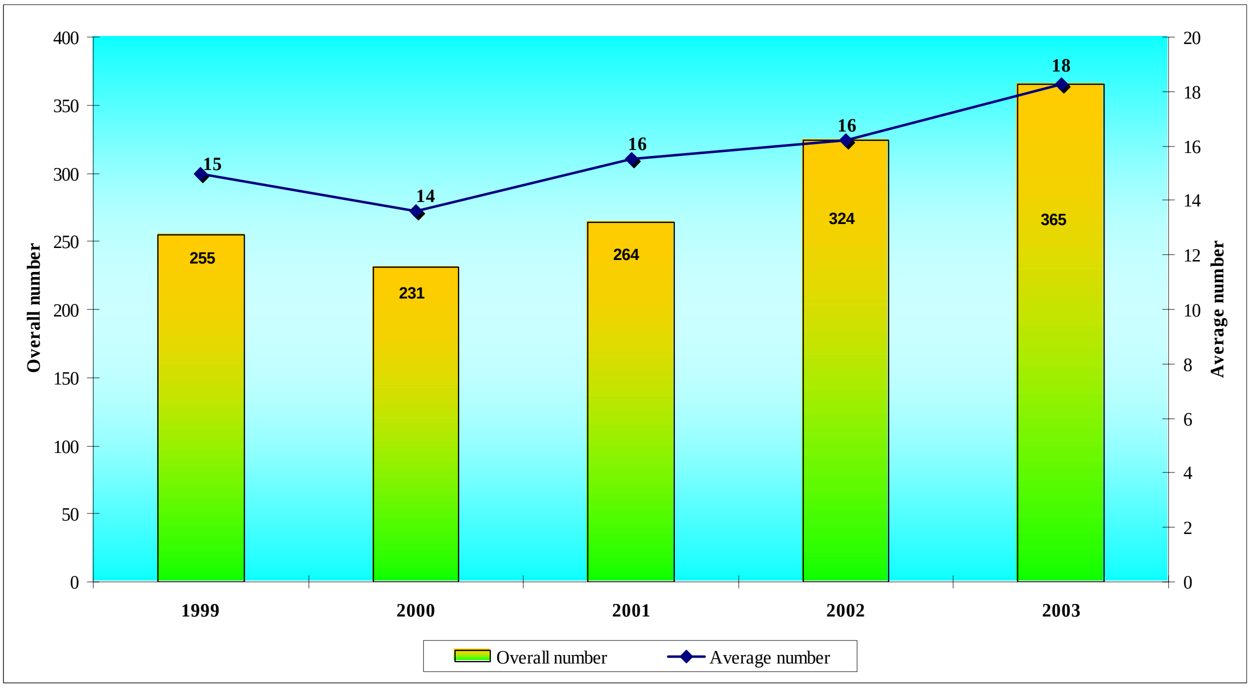
## 4.3. Analysis of the market volumes and trends

Even if a negative trend is observed at an international level in the market of M&A transactions in the 5-year period 1999-2003,[20] corporate finance operations undertaken in that same period by financial institutions included in the reference sample (hereinafter, 'DIR_Investment Banking Sample' will be used for convenience) increased both in terms of total mandates obtained (+43%) and in terms of average number of mandates obtained by each *advisor* (+20%). Besides, – as it can be seen from figure 5 – this last item has increased much less significantly than the previous one, supporting the hipothesis emerged in other contributions[21] that only in recent times this type of activity has started to be supplied on professional basis to firms by an increasing number of operators, most of all – as we will see – domestic commercial banks. This is due to both the positive contribution to the advisors' overall profitability coming from earning generated by such a business area, and the increasing demand for corporate finance services coming from Italian SMEs.

Further confirmation seems to be provided also by figure 6, which shows details of the market trend for each typology of financial intermediary with reference to their operativity in the corporate finance industry.

[20] See Capizzi (2004).
[21] See note 17.

**Figure 5. – The Italian corporate finance industry: number of advisory mandates to support M&A operations**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

**Figure 6. – The Italian corporate finance industry: breakdown of number of mandates according to the typology of the advisor**


*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

Infact, the increase in average number of mandates experienced by domestic investment banks and financial institutions is not surprising. This number is now in line with the one observed with reference to foreign intermediaries (on average 19 mandates per year between 1999-2003, the same with the number revealed by global banks and a bit lower than the average number of mandates obtained by foreign investment banks). What is worth underlining is the fact that the number of obtained mandates by national commercial banks in the same period is not so far from the other typology of operators (with an average of 9 mandates per year). It should also be considered that national commercial banks are highly diversified firms and the corporate finance business area is still a secondary activity with respect to their traditional core businesses such as deposit-taking and lending activities.

Naturally, while interpreting results of the empirical analysis one should be cautious to a certain level. For example, in this case it should be underlined that average number of mandates undetaken by "banks/banking groups" category refers to the declaration of that bank, financial firm or organizational unit, that inside the reference banking group, is specifically dedicated to generate advisory services to actualize corporate finance operations. It means that each unit specialized in corporate finance activities actualize products and services that were originated by other commercial banks belonging to that banking group itself. Although these latter commercial banks don't have the necessary competencies and know how that would enable them to provide those services by themselves, they are capable of supplying this service to their corporate clients by relying on the competencies and know how of the banking group that they belong to. In other words, they enjoy being part of a banking group structure rather than being a completely independent entity.

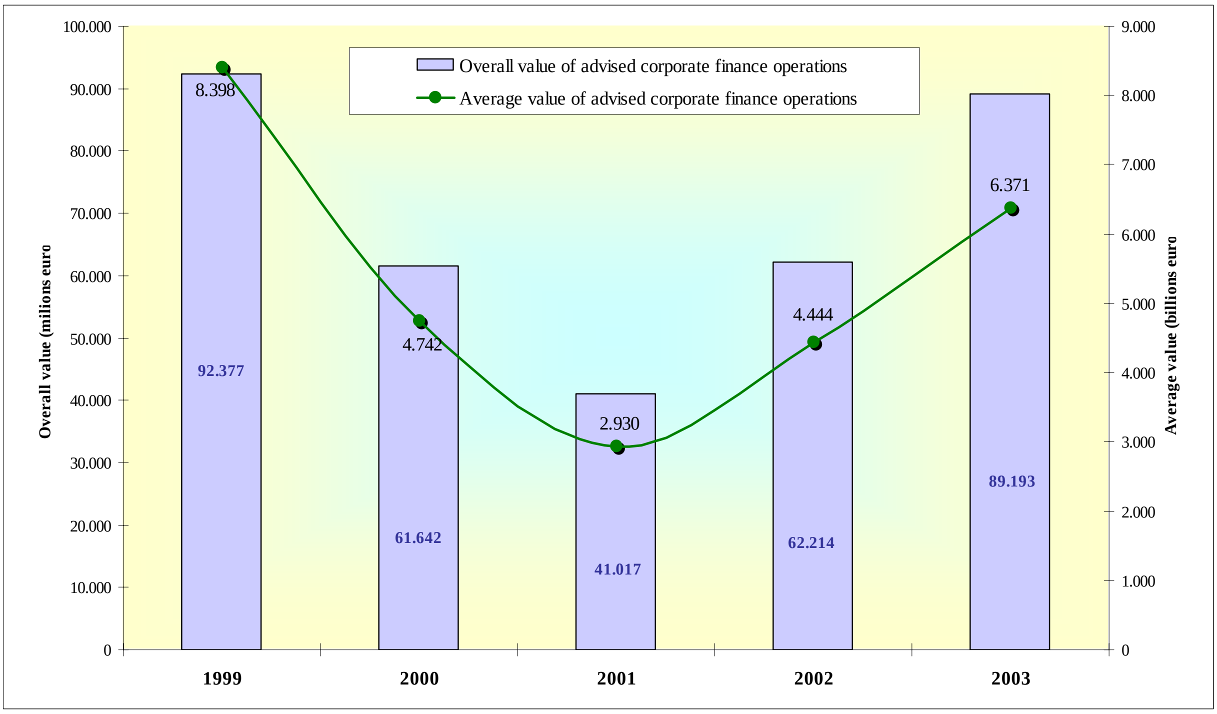
While analyzing the volume of the advised corporate finance operations by the banks in the research sample, it is worth showing that the trend revealed by the SDA Bocconi *DIR_Investment Banking Sample* is not a monotonous one, as already shown by other databases and observations, and follows the growth trend of the home country's major macroeconomic figures.[22] Anyways, in the 5 years observed period, intermediaries in the sample earned an equivalent of 345 billion euro (on average 69,7 billion per year) from their advisory activity aimed at supporting corporate finance operations. On average, each intermediary in the sample advised operations of around 5,3 billion euro each (figure 7).

If, at this point, we enter in more detail by desegregating the data about the volume of operations according to nationality of the intermediary, it is evident that the Italian corporate finance industry is naturally segmented. On the one side, there are domestic financial institutions focusing on small size transactions and, on the other side, there is the presence of big foreign players who advise bigger size operations, among which some are the so-called "mega-deals".

Infact, from figure 8 it can be noticed that by 31/12/2003 foreign operators have supplied advisory services for the benefit of operations of, on average, a bit less than 12,4 billion euro per year, which correspond to around 423 million euro per operation.

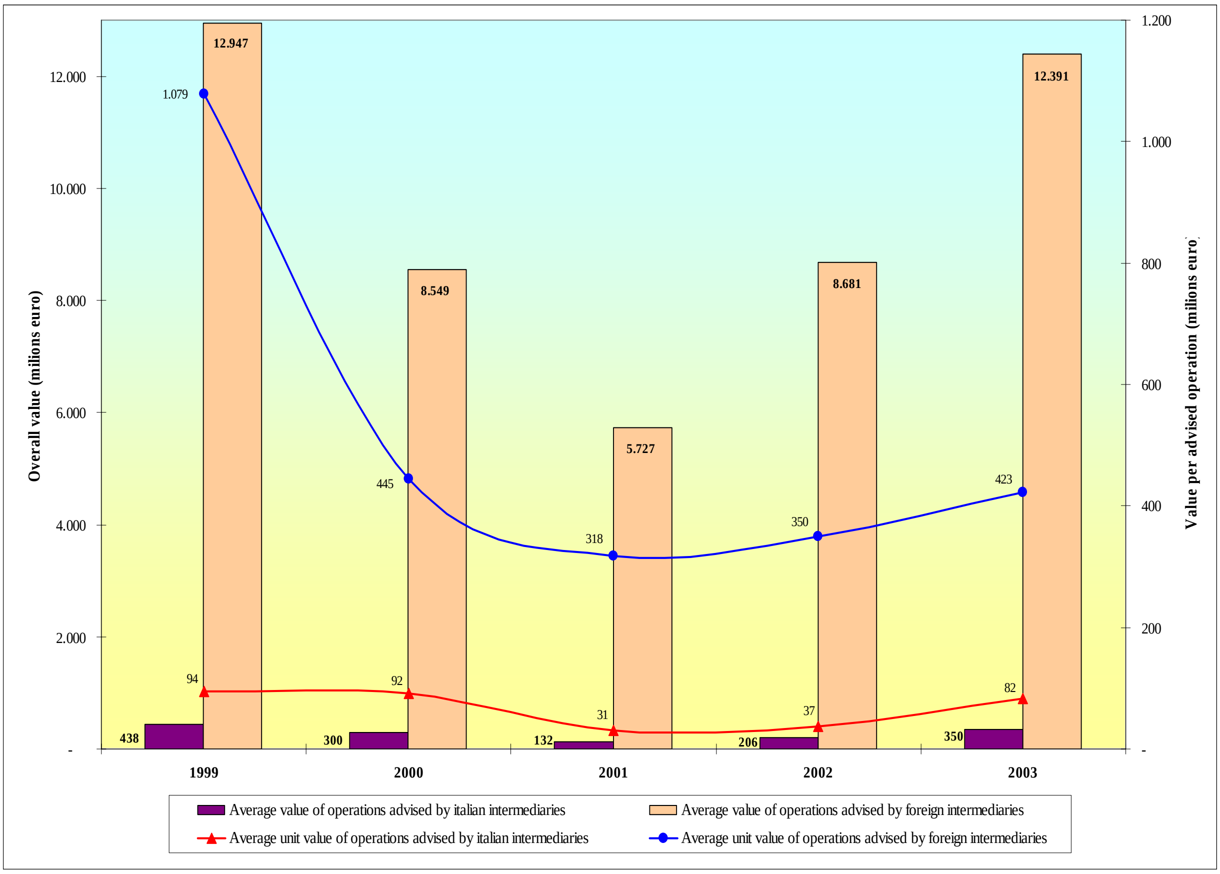
[22] See Capizzi (2004) and Buongiorno, Conca (2004).

**Figure 7. – The Italian corporate finance industry: volume of the transactions advised**




*Source:DIR_Investment Banking Sample SDA Bocconi (2004)*

**Figure 8. – The Italian corporate finance industry: breakdown of volume according to the nationality of the advisor**



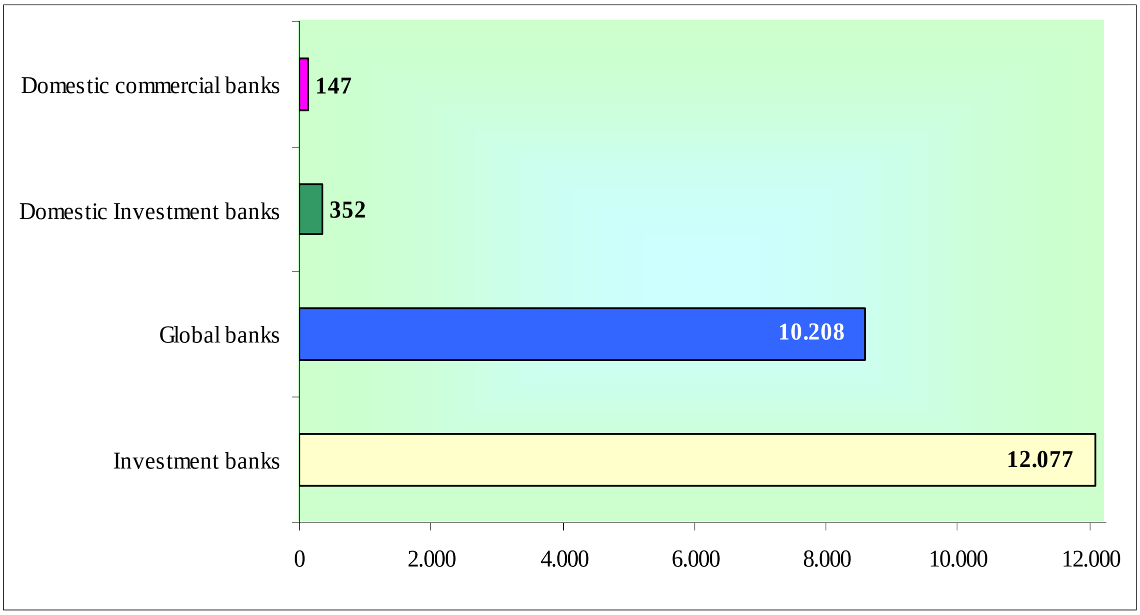

*Source: DIR_Investment Banking Sample SDA Bocconi (2004)*

In this case, we are dealing with operations much bigger in size than those characterizing advisory activity of Italian and investment banks, that, by the end of 2003, on average advised operations of 350 million euro, equivalent to an unit value of around 82 million euro.

Introducing a further segmentation parameter – the typology of the intermediary – in the analysis, it is possible to realize how domestic commercial banks differ from domestic investment banks in their intensity in this area of business (figure 9). They undertook advisory activities in the three-year period 2001-2003 for the benefit of corporate finance operations for an annual value of 352 million euro that is significantly smaller than the one observed in the same period for foreign global banks (10,2 billion euro) and for foreign investment banks (12,billion euro), more than double, however, than the average number recorded for Italian commercial banks and banking groups (around 147 million euro).

It is then possible to sustain that our banking system is actually a marginal operator in the business area of corporate finance services, at least making reference to the distribution of market shares among the major competitors, both foreign and domestic. However, due to both the increasing demand coming from SMEs for assistance to support their transactions and, besides, the limited size characterising these transactions temselves, it is possible to forecast significant and growing opportunities in the market for our credit institutions.

**Figure 9. – The Italian corporate finance industry: *breakdown* of average values according to typology of *advisors* (2001-2003 period)**



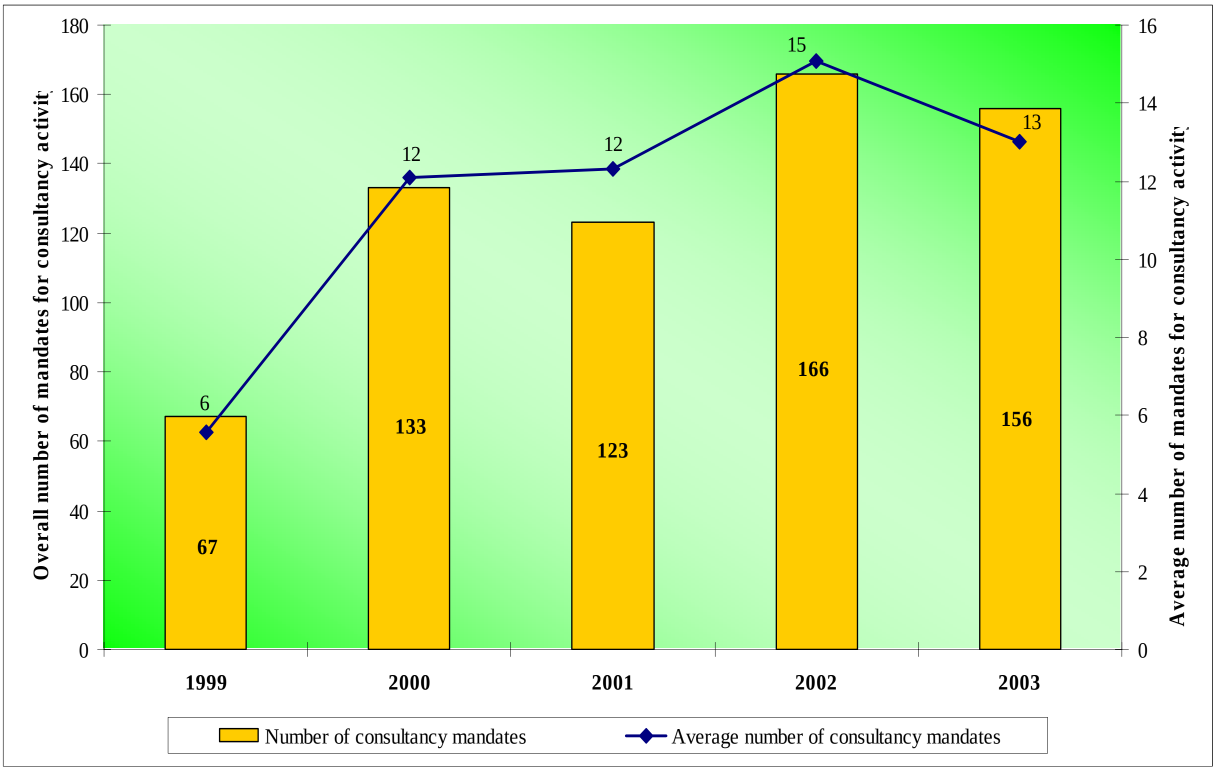

*Source: DIR_Investment Banking Sample SDA Bocconi (2004)*

Naturally, also in this case, we need to be cautious in interpreting results. First of all, we need to mention that the percentage of Italian operators that have revealed data about numbers and value of the M&A operations advised is 50% of the total, while almost the 80% of the foreign operators offering corporate finance advisory services have disclosed this information.

Second of all, the data about the numbers and the volume of operations undertaken by the advisors are rather unstable and influenced by each single actualized transaction. In other words, one big deal is enough to create significant variations in the historical trend and can, at least partially, mislead previous interpretations of the results.

Enlarging the prospective of research from the activities aimed at supporting M&A transactions to pure financial consulting – which falls under the business area of corporate finance services as well – figure 10 shows the significant increase in activities with consulting nature in the period 1999-2003 supplied by the intermediaries in the *DIR_Investment Banking Sample*: The overall number of obtained mandates has increased by 133% around the line throughout the whole research period, as well as the average number financial consulting mandates, which increases from 6 in 1999 to 13 in 2003 with an average annual increase of 23,3%.

**Figure 10. – The Italian corporate finance industry: number of mandates involving financial consulting services**



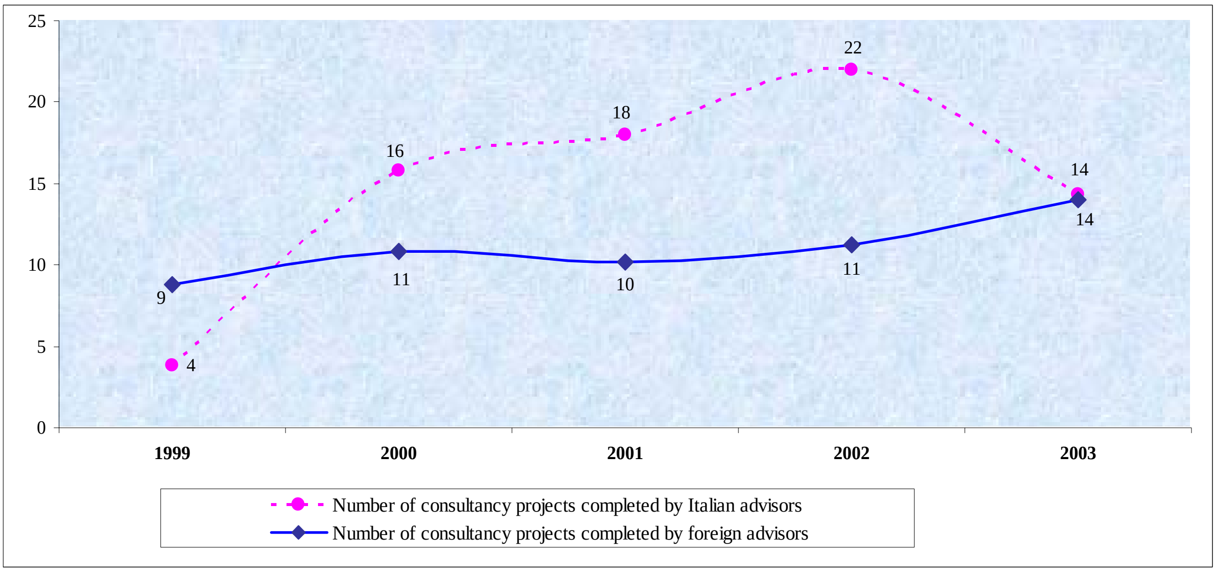

*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

In this case, the most interesting data that emerge from the elaboration of the answers to the questionnaire is the higher number of conultancy projects on average completed by domestic operators with respect to foreign intermediaries. During 1999-2003, domestic operators concluded 15 financial consulting operations whereas foreign financial intermediaries completed 11 in the same research period (see figure 11). This result reflects that foreign operators mostly focus on more specific activity of *advisory* aimed at supporting M&A transactions. This latter activity requires more sophisticated competencies that certainly bring higher commissions than financial consulting activities do, especially if it makes reference to big size operations.[23]

[23] See section 4.3 in this chapter

On the other hand, a further interpretation may refer to the higher relationship aptitude characterising most of all domestic ommercial banks. In this sense, consultancy activity can be seen as a part of a specific strategic choice consisting in fully covering al financial needs – credit related or not – coming from their corporate clients. This is consistent with what emerged during the literature review in section 2, when we realised that the bank-firm lending relationship can constitute a source of competitive advantage for commercial banks in the corporate finance business area. The empirical analysis conducted in this research hasn't yet provided data as to whether the results verified at the international level – which is the better competitive positioning of commercial banks with respect to investment *banks* thanks to their possibility of relying on long-term credit relationships– can be extended to domestic level.

**Figure 11. – The Italian corporate finance industry: breakdown of number of mandates for financial consultancy according to the nationality of the advisor**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

In any case, when interpreting the results of the analysis, the following elements should be considered with caution.

a) This business area deals with a wide and heterogeneous range of services. Given that there are no disclosed details about the scope and the contents of these activities with reference to the financial intermediaries belonging to the sample, it may be that some of the respondents have also included in this category consultancy activities aime at the selling of their credit products.

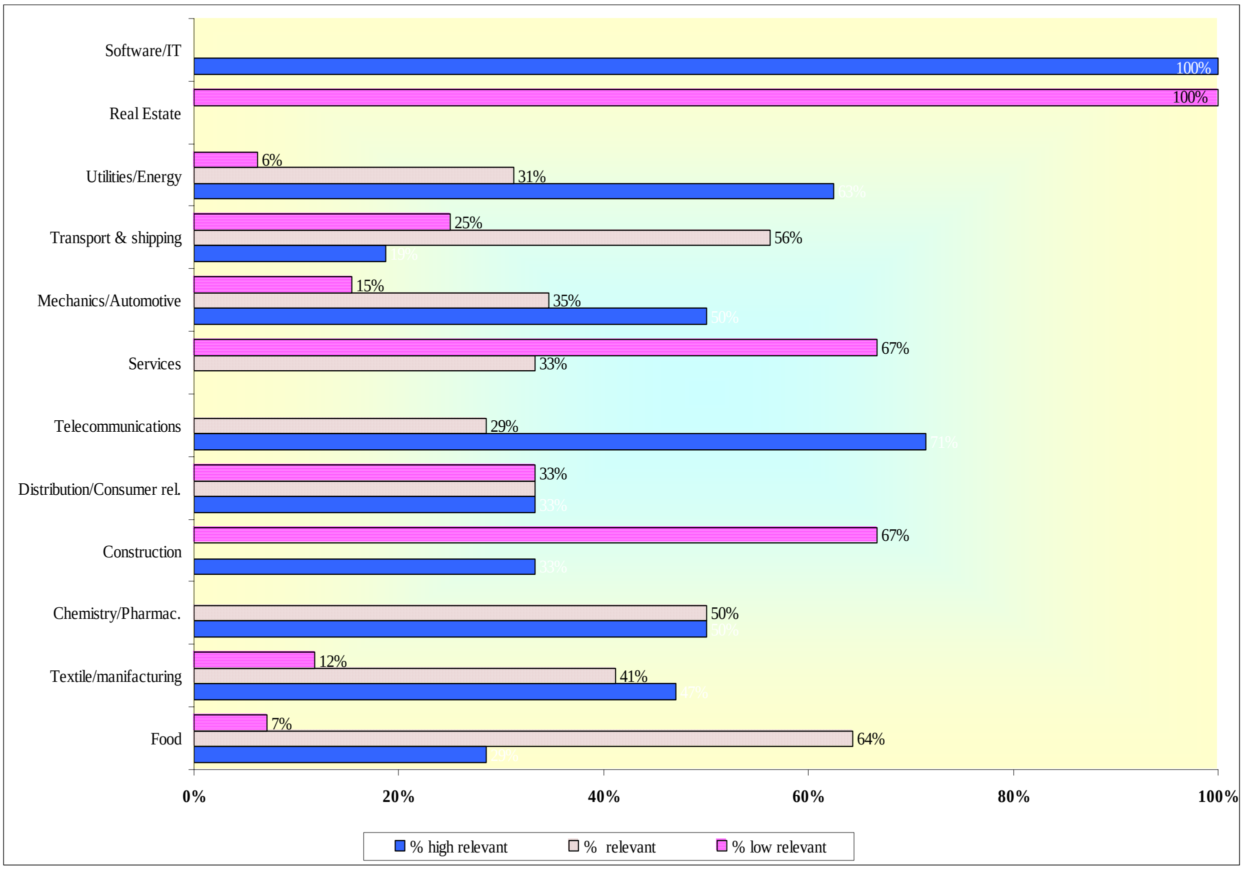
b) There is no information about the size of the consultancy interventions. This makes it difficult to distinguish, on one side, the nature and relevance of the satisfied corporate financial needs and, on the other side, the tipology of the intervention required to the advisor especially in terms of time, human resources and capital to be invested.

c) There is no information specifying whether these services are jointly supplied with others related to either investment banking industry or corporate lending industry. In this sense, it is possible that some intermediaries supply consultancy services on “captive” basis, being a natural consequence of a contractual relationship stemming from a different business area.

d) There is no information about the percentage of completed financial consulting projects regarding national and foreign intermediaries, and, even more in detail, commercial and investment banks.

One last interesting aspect emerging from the analysis of the growt trend of corporate finance services performed by the reference banks is the breakdown of the activity according to corporate clients’ industries (see figure12).

**Figure 12. – Breakdown of the demand for corporate finance services according to corporate clients’ industries**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

By elaborating answers to questionnaire’s question asking which industry originates, on average, the greatest demand for advisory services related to corporate finance operations, it has been possible to identify three groups that are perceived with different relevance by the financial intermediary.[24] The first group includes those sectors that are considered very relevant because evidently they generate high number of operations over time and, besides,

[24] Groups have been being constituted basing upon the answers given to the following question: “*Indicate, ordering by importance, the five industries having the most transactions (1 =very important, 5 = not very important)*”. When elaborating the results, depending on the points assigned by the answering banks, each industry has been judged, respectively, as “high relevant” (points 1 and 2), “relevant” (points 3 and 4) or “low relevant” (points 5)

these are big size operations. This is the case for information technology (software), telecommunication, utilities, chemistry, and mechanic (particularly automotive parts). Transportation, food, and manufacturing (particularly textile) are judged as moderately relevant by the intermediaries. Finally, real estate, construction and service industries seem to be of limited interest for banks and investment banks.

These results, on the one hand, are not surprising as one would expect that the lower the industry capital intensity, the lower the need for external growth programs, on the other hand, however, make it possible to forecast a potentially high expected demand most of all for turnaround and capital structure reconfiguration services coming from small and medium sized enterprises, operating in high-technology – and high financial needs as well – industries. It's presumable these firms – that, as signaled by official source of information, make up 25% of domestic industrial system[25] – won't be able, without such corporate finance operations to resist to the competitive attack launched by foreign companies, that can rely on their greater efficiency due to: economies of scale; higher research and development investments; access to lower cost resources.

## 4.4. Characteristics and contents of the undertaken activity

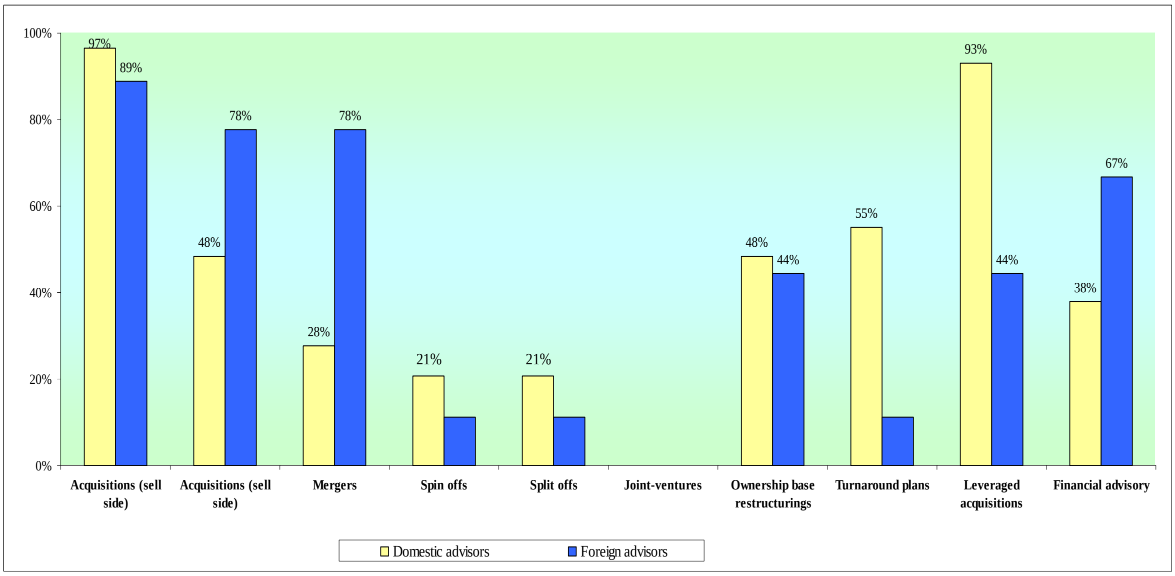
This section concentrates more specifically on the characteristics of the production activity undertaken by the intermediary to satisfy the demands of client firms. A series of relevant aspects are brought into attention with reference to both the typology of advisory services and the strategic-structural requirements of the reference financial intermediaries.

By observing the typology of advised operations, and trying this time – in comparison with evidence presented in figure 1 –to disaggregate the sample according to the nationality of intermediaries (see figure 13), it is possible to extract the following considerations.

- The domestic advisors supply advisory services more focused, in comparison with foreign operators, on, first, turnaround services toward distressed firms and, second, on the implementation of leveraged acquisitions. The higher frequency of turnaround services can be explained by the fact that they are above all banks having credit exposures toward distressed firms that find it convenient to try to design and implement recovery strategies rather than implementing the official legal proceedings indicated by national laws. Figure 14, in fact, shows that commercial banks and banking groups, for which most typical activity imply giving loans to national firms, are the operators that are more frequently involved in this kind of advisory services. Coming to leveraged acquisitions, it has already been underlined that these operations are particularly well suitable to manage corporate governance problems, which are essentially related to the family nature of the majority of domestic firms' ownership structure. It is then not surprising that they are the banks with the highest territorial penetration, with their possibility to rely on their existent long-term bank-firm relationships, that are more capable of identifying and fully satisfying this kind of financial needs.

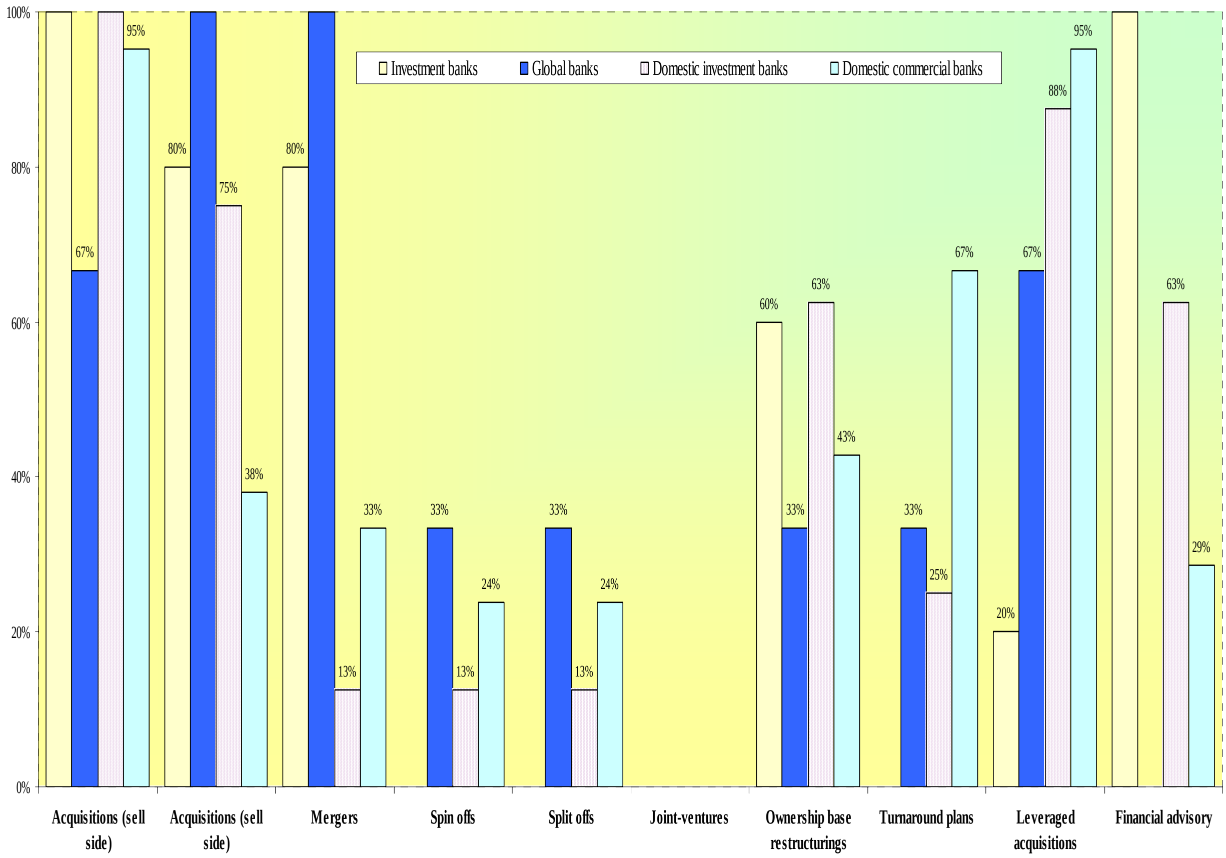
[25] See Tripodi (2004), ISTAT (various years).

**Figure 13. – Breakdown of corporate finance services according to nationality of the advisor**




*Source:DIR_Investment Banking Sample, SDA Bocconi (2004)*

**Figure 14. – Breakdown of corporate finance services according to typology of advisor**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

- The domestic advisors undertake a significant volume of advisory services aimed at supporting entrepreneurs desiring to sell their majority equitystakes, even slightly more significant than that performed by foreign advisors. For these last ones, besides, there isn't a relevant difference – as observed for domestic operators – sell-side M&A mandates and buy-side M&A mandates. Such an evidence seems to be consistent with the argument presented in the section devoted to the literature, that is the higher capacity of the commercial banks to utilize private information about firms to be sold, due to their long-term estabislhed credit relationships.
- Foreign advisors – and in particular top-tier investment banks – are more active than national financial intermediaries in supplying advisory services toward potential buyers, in order to allow them to both acquire other firms and, eventually, to proceed to a merger inside the acquiring firm. This is not particularly surprising, also taking into consideration that, as seen in section 2, in this particular segment of activity advisor's reputation and know how seem to be the most critical success factors.
- Foreign advisors, on average, offer more financial consultancy to firms than domestic commercial banks and investment banks do. One of the reasons might be the wide range of competences that foreign advisors have. This gives them a relative advantage in interpreting financial needs of the firms and in proposing more adequate solutions. On the other side, however, one should keep in mind that for many commercial banks financial consultancy is not normally commercialized as an autonomous service, but is rather seen as a tool necessary to generate and maintain customer relationships, which can then generate both corporate loans or corporate finance mandates.[26]

Figure 15 disaggregates the sample according to the the size of the intermediaries (making reference to the accounting value of their total assets), in order to bring into attention some other interesting aspects regarding their operativity in the corporate finance industry. In particular, the fact that all different products and services in corporate finance belong to the supply system of all the size categories of the reference intermediaries seem to be a further confirmation of the fact that, in the analysed industry, economies of scale do not represent a critical success factor. As it will be seen, there are other conditions on which depends the capability of an advisor to gain competitivity in such an industry.[27]

In this respect, the empirical analysis once more seem to confirm that, as it was already noticed in the previous paragraph, there are interesting business opportunities for domestic small and medium sized commercial banks. If we keep in mind the fact that in the sub-group of small sized intermediaries we first of all find commercial banks with a prevalently regional and sub-regional focus, and, besides, that their typical clients are small and medium sized enterprises mainly family owned and managed, it shouldn't be surprising that these intermediaries are very active in advisory services aimed at both supporting sellers in M&A transactions and implementing leveraged buy-out transactions.

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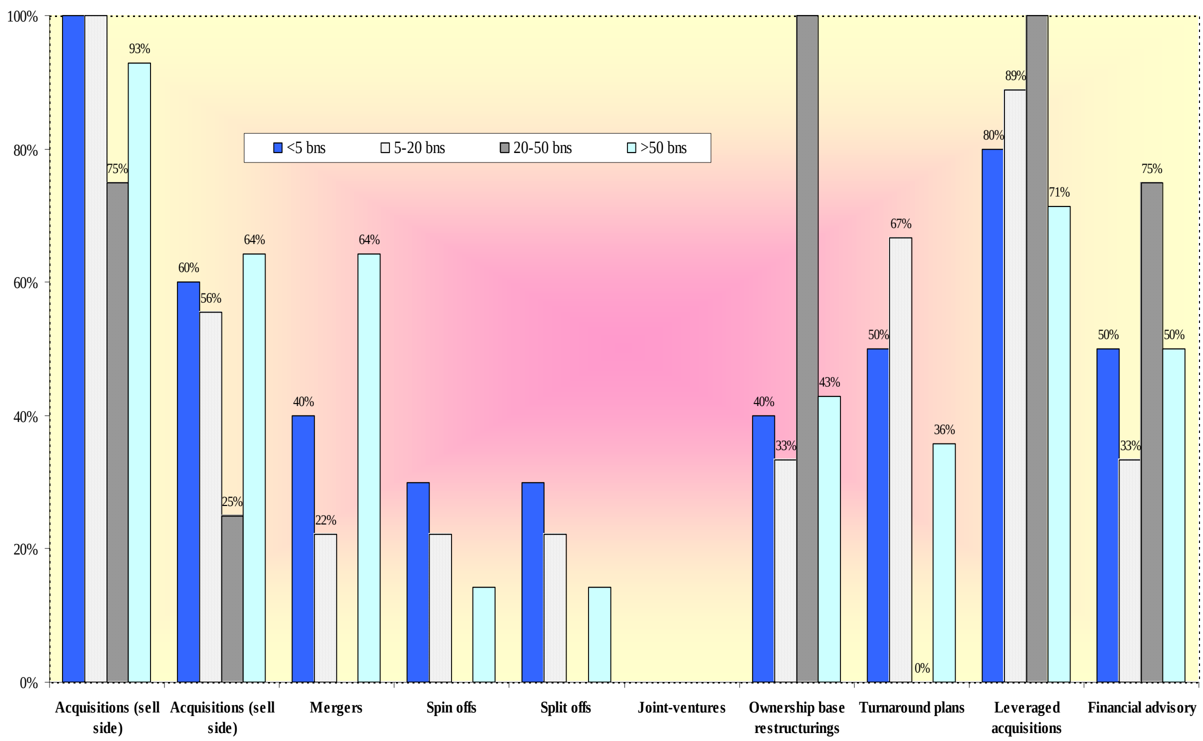
[26] This evidence does not oppose to section 4.1 about the number of financial consulting mandates that have been completed, given that such an item does neither provide information about the total number of mandates originated nor about the importance that the intermediary assigns to financial consulting activity.
[27] See Forestieri (2003b); Kolasinski, Kothari (2004); Saunders, Srinivasan (2001).

It is also notable that there has been little interest by big operators for advisory services to support restructuring of distressed firms. Probably, the reason for such a phenomenon lies, first, in the lack of existent lending relationships with distressed firms; second, in the limited weight of doubtful loans in loan portfolio of big banks; third, in the difficulty of being remunerated in the short-term by the consultancy supplied. For small sized operators, vice versa, restructuring debt of a distressed company could be part of an intended strategy aimed at managing the insolvency state and, hence, at protecting their own credit exposures in a medium-long term perpsective. It should be added that, with reference to bigger sized operators, investment banks would have to face further problems. These problems are represented by the difficulty of gathering private information about the causes of crises and future prospective solutions by firms that are intrinsically less transparent, and, moreover, by the absence of lending activities in their supply system, which exclude the possibility of participation to a turnaround plan with capital injections, either risk capital or debt capital.

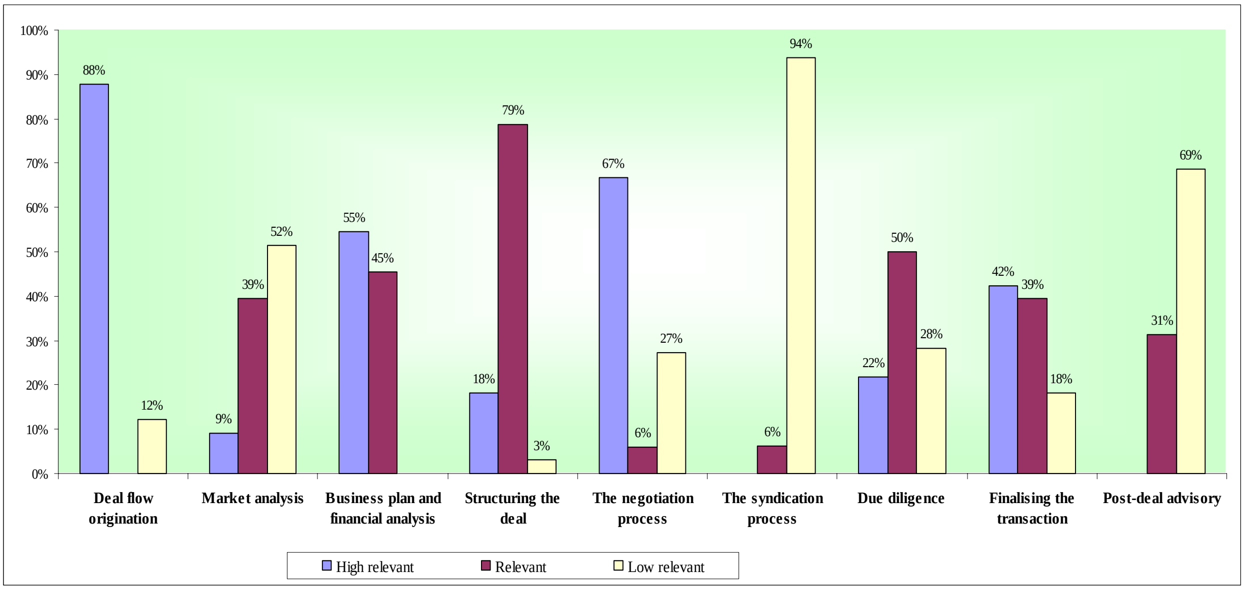
**Figure 15. – Breakdown of corporate finance services according to size of advisor** ***(billions euro)***




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

For what concerns the strategic and structural conditions necessary to financial intermediaries to operate as advisors in the corporate finance industry, and limiting ourselves with advisory services in the M&A business area – and in particular with the analysis of the production process of the intermediary receiving the mandate to advise the seller – the first aspect that should be underlined is the fact that, making reference to the different phases identified in section 3, the activities judged as the most critical by the reference intermediaries are, respectively, the origination of the deal, the management of the negotiation process and the actualization of the financial analysis necessary to write business plans and define negotiation prices (see figure 16).[28]

**Figure 16. – Perceived relevance of different phases in the production process of an advisor in an M&A operation (sell side)**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

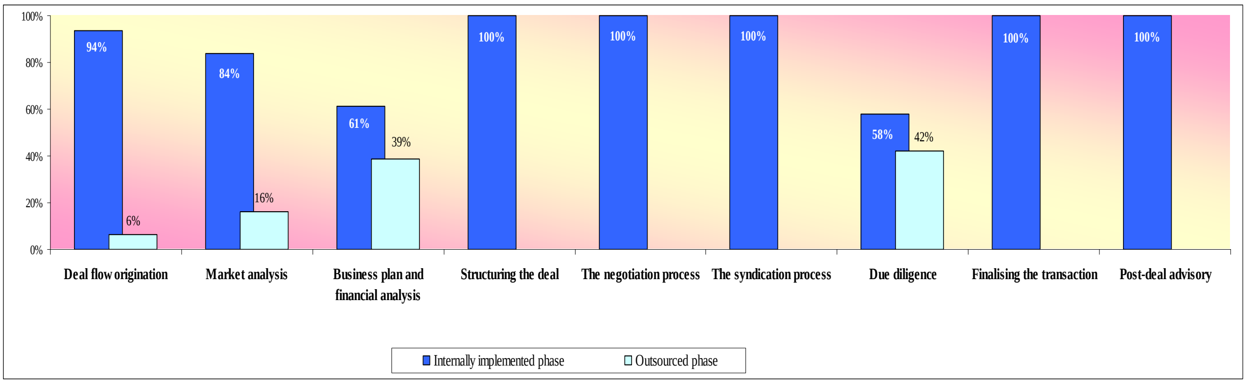
The phases associated to the management of syndication process (related to the financing issues of the deal), the post-deal advisory, the market analysis, and the structuring of the deal are considered less important - that is, less difficult to manage – in order to obtain a stable and unique competitive advantage. So, what seems to be emerging is the higher importance of the phases that either have a relational content or require specific technical – mainly financial – competencies; among the latter, for example, there is the capability to appraise companies basing upon the discounted cash flow analysis and to construct appropriate business plans capable of supporting the negotiation process in an M&A operation.[29]

Consistently with what has just been shown, figure 17 shows that reference banks in the sample use most frequently to outsource the phase related with the finalisation of business plan and financial analysis, given its perceived relevance, by utilizing the know how of professionals or advisory firms or organizational units belonging or not to the banking group itself.

Due diligence is a different case, given that in this phase the nature of activity to be perfoemed and the absence of synergy with other phases of the production processes give way to get access to specialized professionals, that are mostly audit companies.[30]

[28] See note 24 for the criteria used in order to identify the different categories (high relevant, relevant, low relevant).
[29] In this sense, see Capizzi (2003a, 2003c, 2003d).
[30] See Conca (2001), Capizzi (2003d).

**Figure 17. – Percentage of outsourced versus internally implemented phases of the typical production process in an M&A operation (sell side)**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

To be cautious in the interpretation of the results of the empirical analysis, we should always consider the fact that majority of the operators in the *DIR_Investment Banking sample* are consisted of commercial banks. So, it is not surprising that majority of the phases that are considered as less complex refer to activities that banks normally undertake also while performing their more traditional operations in the corporate lending business.

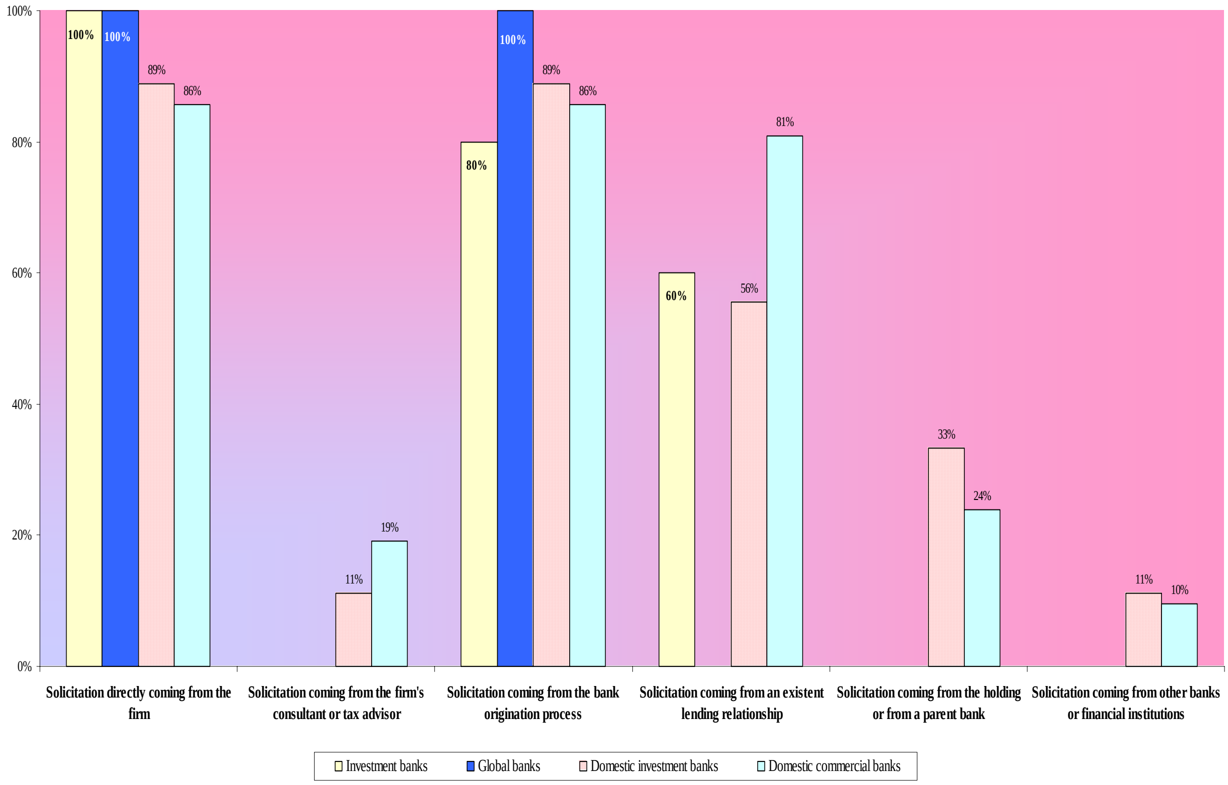
Before proceeding to examine critical factors of success, competencies and resources required to operate in this business area, we would better elaborate on one of the phases in the production process of the advisor just evidenced as relevant, that is the "deal flow origination", in order to verify whether there are significant differences in the way that different categories of financial intermediaries manage this crucial activity in the corporate finance industry.

In this respect, figure 18 brings into light the different modalities chosen to generate advisory services, respectively, by domestic operators (either commercial banks and banking groups or financial companies and investment banks) and foreign intermediaries (either *global banks* or *investment banks*). The latter seems to rely first of all on their *reputation*, obtaining the majority of their mandates on the basis of direct solicitation from the customers or from screening activities directly performed by own professionals. However, it is clear that lack of territorial penetration inevitably leads to an extremely selective approach in the origination phase that – it is woth underlining – is not generally subject to a specific remuneration.[31] Domestic advisors use to the same strategic options just described, although their lower quality reputation in the area of investment banking services and their larger territorial coverage generate different typologies of mandates, as seen, both from a qualitative and quantitative standpoint. On the other hand, however, the national advisors and in particular commercial banks rely on further more options to obtain mandates,basing upon either their existent bank-firm relationships generated by lending activities, or the deal flows canalized by other banks or financial firms of the reference banking group, or, again, on the relationships with other financial institutions not belonging to the same banking group. At the end, also relationships with consultants and tax advisors seem to be a significant source of mandates; in fact, these operators, particularly in the case of domestic SMEs, play an important role of consulting and intermediation with the actors of the national financial

[31] *Ibidem*.

system. Similar channels, that does not seem to be efficiently exploited by big foreign players, at least without significant and deliberated structural investments, gives a competitive advantage to domestic banks, who could benefit from their proximity to the most relevant client segment in the Italian corporate finance industry.

**Figure 18. – Breakdown of M&A mandates' origination options according to nationality and typology of advisor**

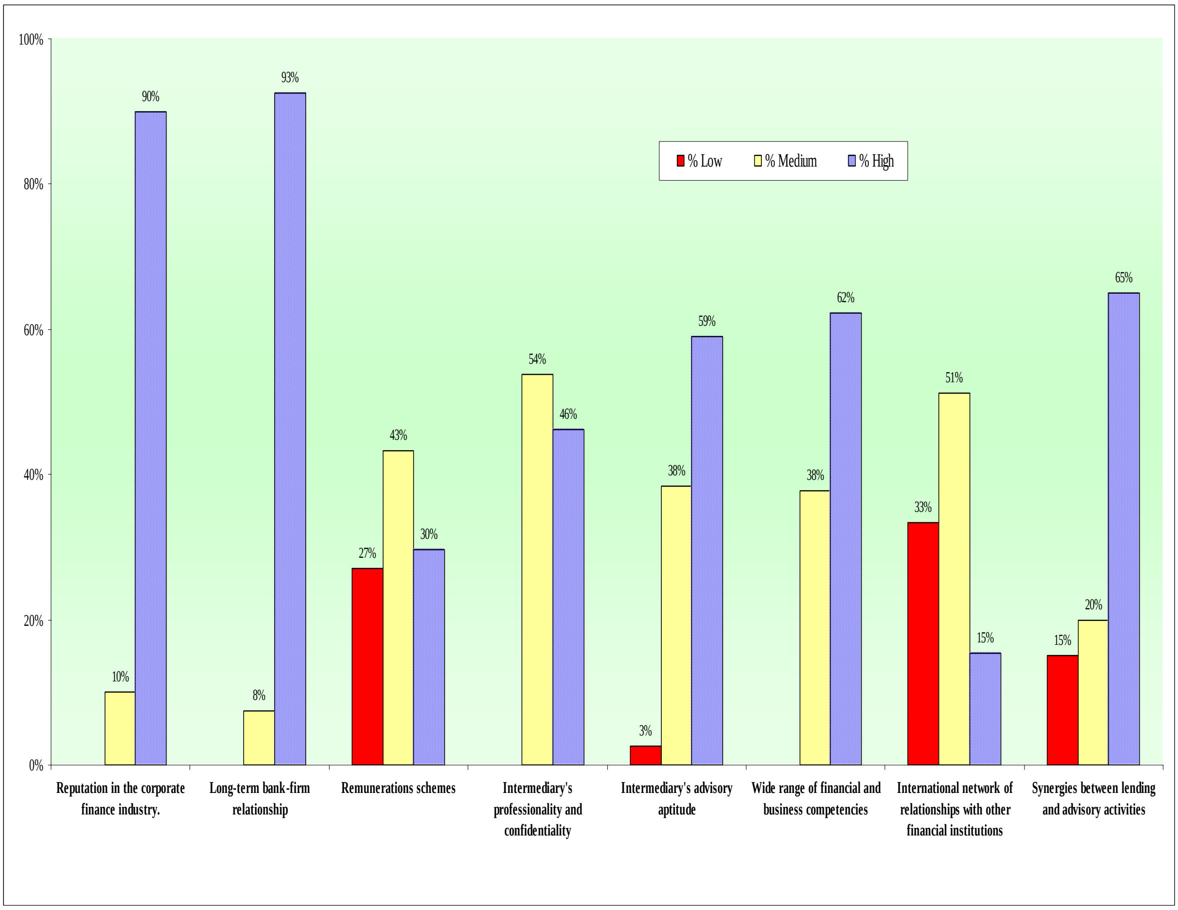



*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

Concluding with a review of the key success factors and competencies typically required in the analysed business area, figure 19 shows that the intermediaries in the sample share a common opinion about the sources of competitive advantage, which can be essentially referred to the reputational capital, on the one hand, and to the existent relationship with the corporate clients, on the other.[32] According to what we have already observed so far, it seems rather reasonable that investment banks and big international players point out the first factor while domestic commercial banks are better at relying on the second critical success factor. The other factors that are considered to be relevant by the operators in the sample are all connected with the choice of each one about the relative importance of the above mentioned two factors. It is clear, in fact, that for who points out to increase his visibility and reputation in the corporate fionance services business area, the possession of a wide and depth range of financial competencies is inevitable, while for who points out the existent relationship with the clients, trying to maximize the existent synergy potential between financing and advisory activities will be critical.

[32] See note 24 for the criteria used in order to identify the different categories (low, medium, high).

**Figure 19. – Perceived key success factors in the Italian corporate finance industry**



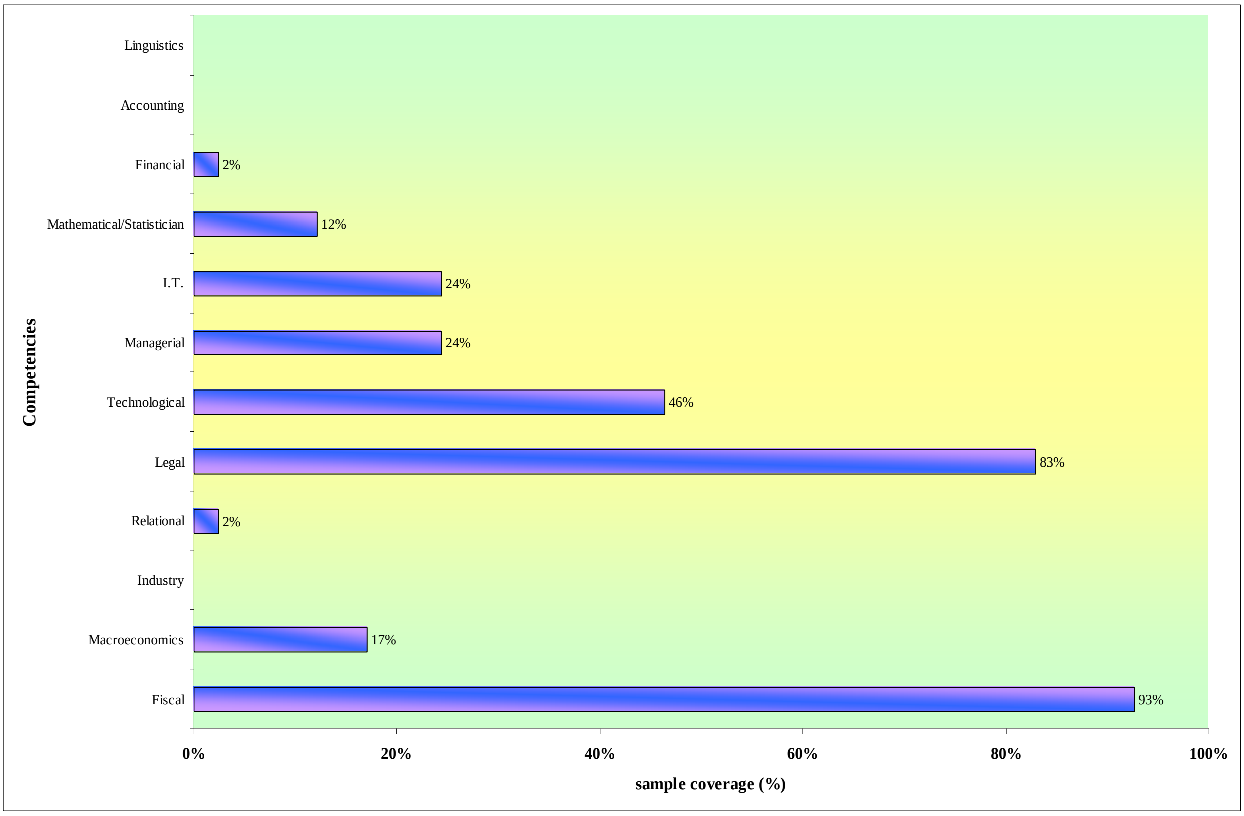

*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

Vice versa, it is not considered to be relevant to the majority of the intermediaries in the sample, in the first place, the possession of an international network of relationships with other financial institutions. This may be due to the peculiar quali-quantitative characteristichs of the demand coming from domestic SMEs. In the previous section, in fact, it was shown that average volumes characterizing the transactions involving domestic firms do not normally require capital inflows from abroad. On the other hand, contributions dealing with the business area of capital markets services evidence that, given the relevance also from a quantitative standpoint of the operations to be actualized, the capability to make reference to a network of international relationships with other financial intermediaries is fundamental in order to operate in a competitive way in the area of capital markets services, so, for example, to be able to proceed to the underwriting and selling of great amounts of fixed-income securities.

In the second place, it is not considered as a key success factor the contractual shape of the remuneration shemes, that is to say the possibility of differentiating the service supplied on the basis of either the amount or, most of all, the typologies of the fees charged to client firms. Such a result is consistent with the argument previously presented regarding the fact that, inside the reference intermediaries, a natural segmentation of the market seem to emerge; in other words, each typology of advisor focuses directly on the segment of firms that is more consistent with its supplied range of products and services, in terms of both quality and price. In any case, benefits coming from economies of scale wouldn't be relevant in the corporate finance industry. On the contrary, as the majority of the reviewed literature predicts, applied price conditions seem to be proportional with the reputational capital of the advisor, making it difficult for SMEs getting access to top-tier investment banks.

Once identified the key success factors in the analysed business area, it is then possible to understand why, basing upon a cost-benefit analysis, some competencies are internally developed and maintained by the bank or its organizational unit dedicated to the production and supply of advisory services and why others, vice versa, are externally acquired by the advisor (see figure 20).

**Figure 20. – Competencies externally acquired by the advisor**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

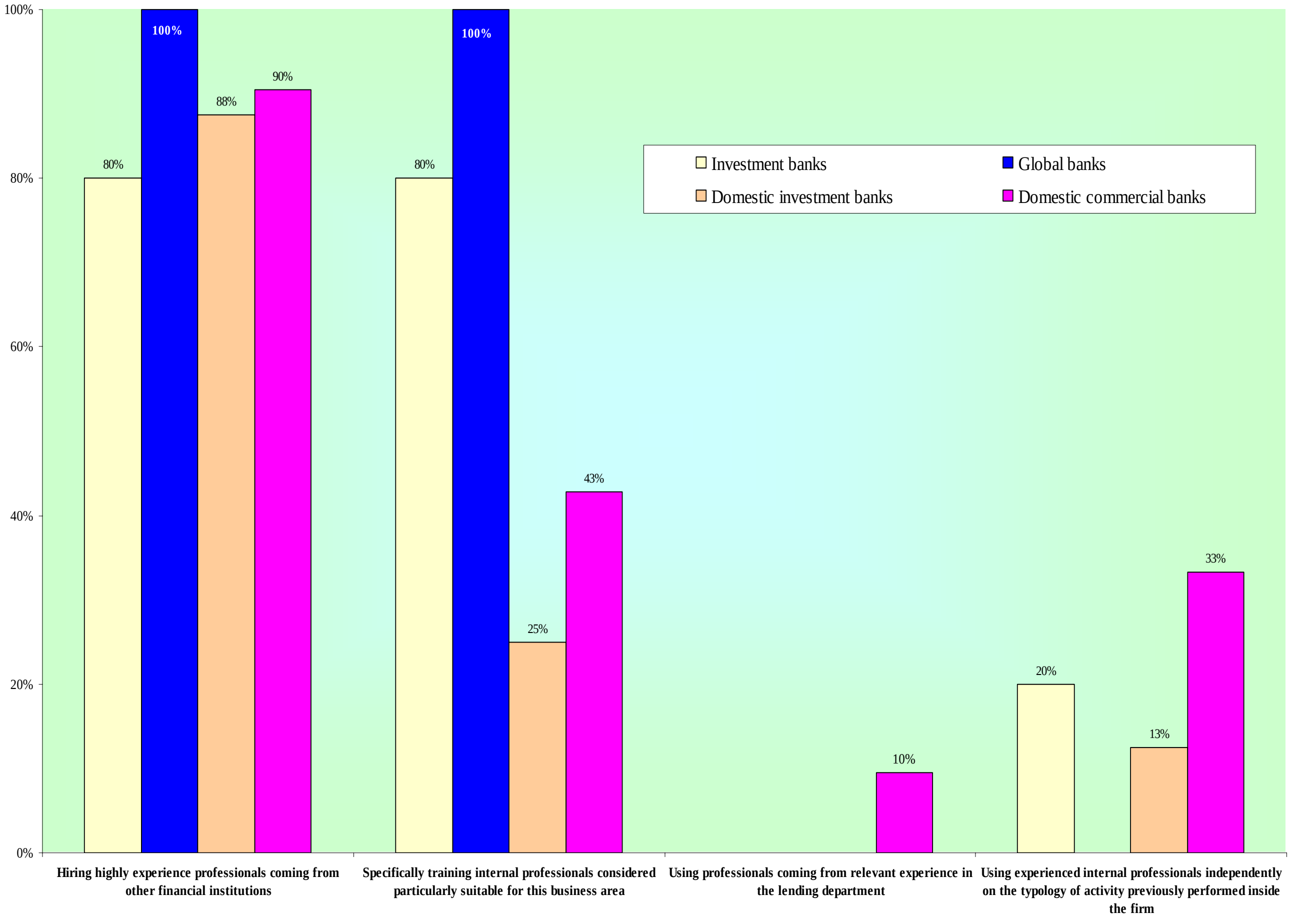
Among the first category, we find competencies that are essentially technical (capability to actualize industry analysis, balance sheet analysis, historical and expected financial analysis, capability to prepare a *business plan* and an information memorandum, and so on) and relational (the deal flow origination, the negotiation and finalisation of a given deal, the post deal advisory). Among the second category, we find fiscal and legal competencies followed by the industrial ones, which involve the knowledge of specific production technologies, and business management competencies as well. These last ones, as easily understandable, become particularly relevant in the area of merchant banking services.

At this point, if we refer to the *DIR_Investment Banking Sample* as segmented by typology of advisor, the following two elements should be given attention:

a) with reference to technical competencies, while the capability to perform in-depth financial analysis and to elaborate business plan seems to be present and widespread at any level of the organizational structure of foreign advisors, in the case of domestic operators, and in particular commercial banks and banking groups, the same capability seem to be concentrated inside those organizational units dedicated to firms' creditworthiness analysis. This, in turn, is consistent with the great value attributed by literature to the private information extracted by banks through their lending activity, but, at the same time shed light to a potential weakness of these intermediaries, if not adequately managed;

b) with reference to relational competencies – normally managed by corporate bankers and in any case by senior professionals with proved experience in the analysed industry – commercial banks seem to rely on choices of acquisition and maintainance that are different from those undertaken by other intermediaries and, furthermore, do not guarantee a full exploitation of synergies originating either from the relationships generated over time with the clients by banks' professionals, or from the technical competencies in any case necessary to perform effectively this activity; even the latter imply a growing experience over time (see figure 21). In other words, the quality of the bank-firm relationships established by investment banks in the corporate finance industry seems higher than commercial banks' one.

**Figure 21. – Modality of acquisition of *senior* professionals in the business area of *corporate finance* services by the sample reference intermediaries**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

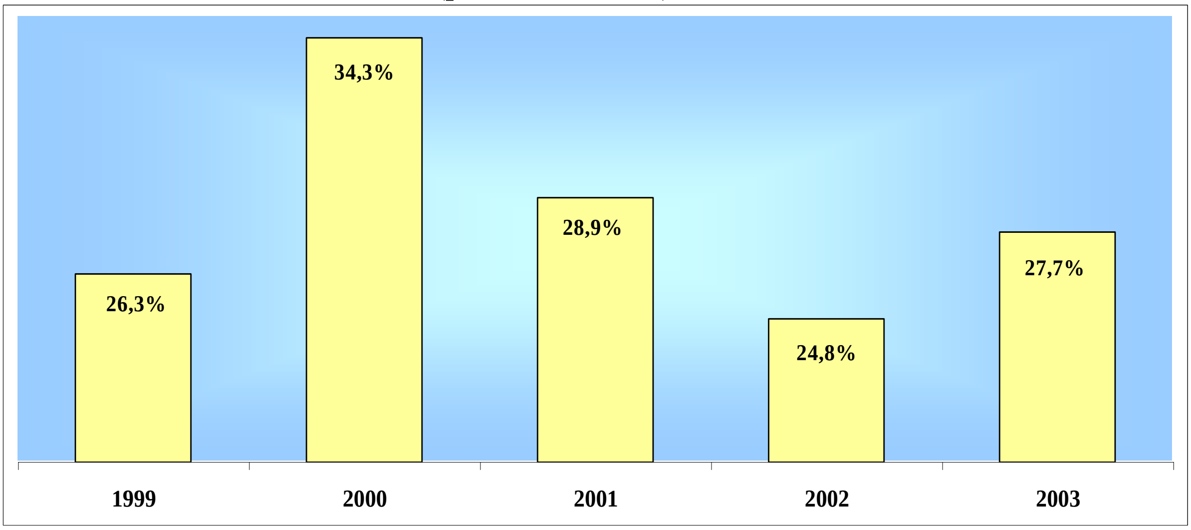
## 4.5. Profitability of the analysed business area

This last section of the empirical analysis is dedicated to an analysis of the economics characterizing the subjects involved in the advisory activity to support the actualization of corporate finance operations. In this way, after having discussed about the peculiarities of the production process and about the acquisition profile of the key competencies required, it is possible to complete our picture of the strategic and structural factors needed to successfully compete in the analysed business area.

Taking into consideration the usual research period (1999-2003), it is possible to observe that the profitability margin coming from the operativity in the corporate finance industry – as measured by the percentage of commissions generated by this activity over the total value of the balance sheet item "net income from services" – alhtough characterized by an inevitable volatility over time, shows an average value of 28,4% and in none of the years in th reference period it goes below about 25% around majority of the income generated by the total volume of investment *banking* services (see figure 22).[33] Corporate finance is without doubts one major value generating activity in the economics of the sample reference banks.

Naturally also in this case, one should be cautious – as it has already been mentioned – about the significance of the data. Here, the observed volatility, among other things, is also due to the high weight of some big size transaction – with consequent effects in terms of *fees* earned by the advisors – that do not show a regular and predictable trend over time.

**Figure 22. – Percentage of income generated by corporate finance activity over the total net income from services (period 1999-2003)**



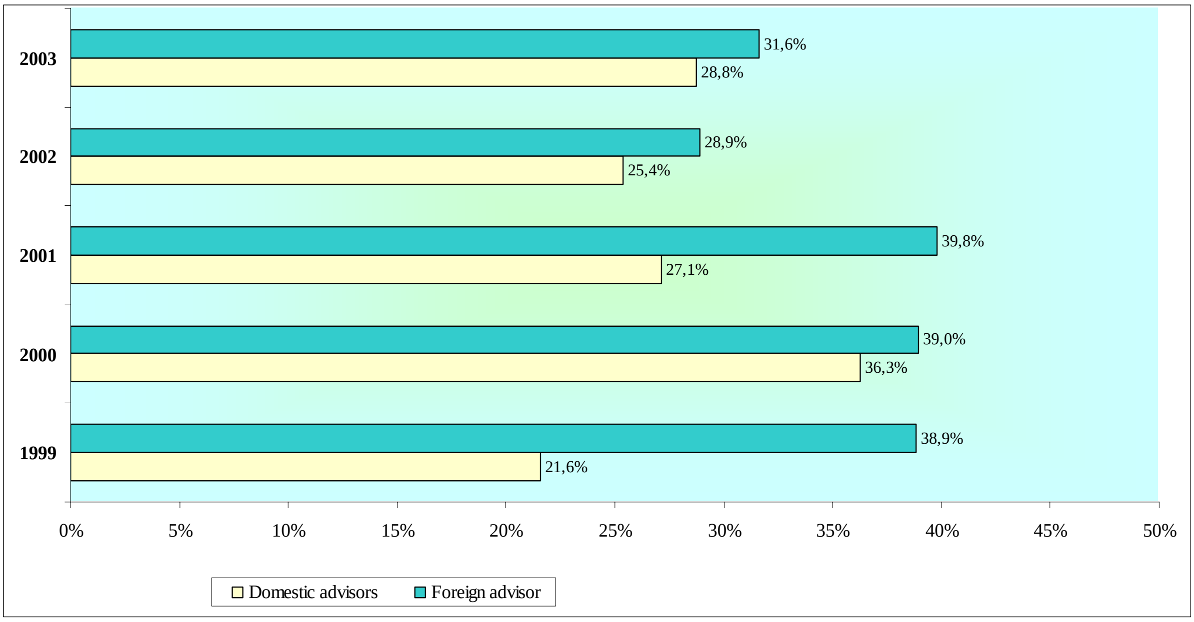

*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

[33]In this respect, one should takes into consideration tha investment banking activity – and, more in particular, the corporate finance business area – generates income most of all as fees and commissions, hence directly affecting the balance sheet item "net operating income before expenses". See Mishkin (2004).

Next, once the sample of advisors is segmented according to nationality, a rather relevant result emerges: foreign intermediaries in each year of the 5-year research period demonstrate a higher value in their profit margin with respect to national operators, and in some cases with significant differences  (see figure 23).

As a matter of fact, the average value calculated for foreign advisors for the whole research period (35,6%) is well above the average value calculated for Italian banks and investment banks (27,8%). In any case, it is worth underlining that the profitability gap between domestic and foreign intermediaries is progressively decreasing (from -17,3% in 1999 to -2,8% in 2003): the Italian financial institutions – and among them commercial banks – are covering available market spaces answering more and more completely to corporate clients needs.

**Figure 23. – Percentage of income generated by corporate finance activity over the total net income from services: breakdown according to nationality of advisor**

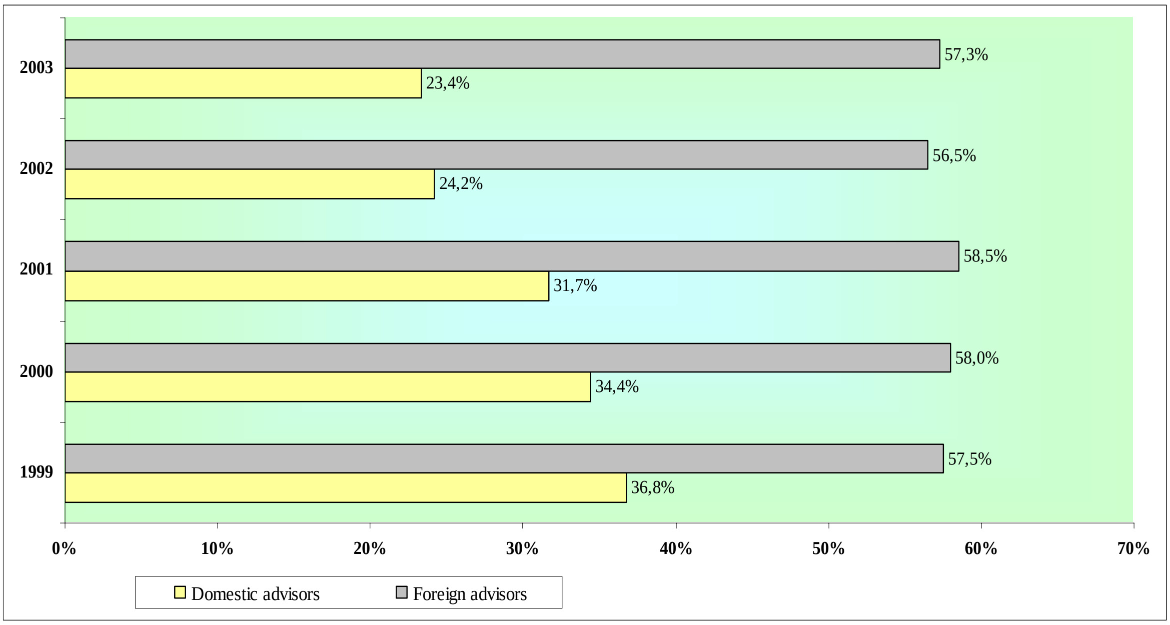



*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

One may then interpret the observed profitability differentials through the argument that most probably foreign operators are present in the Italian market with competitive strategies very focused on specific product/market combinations, among which there are activities related with corporate finance services. We are obviously referring to global banks, given that investment banks are by definition characterized by a less diversified and less heterogeneous operational profile with respect to typical commercial banks.

Furthermore, the higher focus of foreign intermediaries on corporate finance activity appear to be consistent with the results shown in figure 24. In the case of foreign operators, percentage of personnel dedicated to corporate finance activity is clearly higher than the one revealed by domestic operators, with an average 58% for the former and an average 30% for the latter over the whole referece period. It is also notable that lack of data about the absolute values of the number of dedicated professionals, do not allow to express hypotheses about the existence and the relevance of benefits coming from scale economies available to both Italian and foreign financial institutions supplying corporate finance services.

**Figure 24. - Percentage of personnel dedicated to corporate finance activity over the total employed personnel in domestic and foreign intermediaries (period 1999-2003)**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

An alternative explanation to that basing upon intermediaries' diversification level refers to higher pricing conditions applied by foreign operators, typically characterized by a higher level of reputation. In this sense, this argument would be consistent with the theoretical contributions mentioned in section 2, that have studied the price conditions applied by different typology of operators in the M&A services business area.[34] As it has already been hypothesized, it is possible that lower fees applied by domestic commercial banks might be a deliberated strategic choice that should be considered instrumental to generate and maintain over time strong and reliable bank-firm relationships.

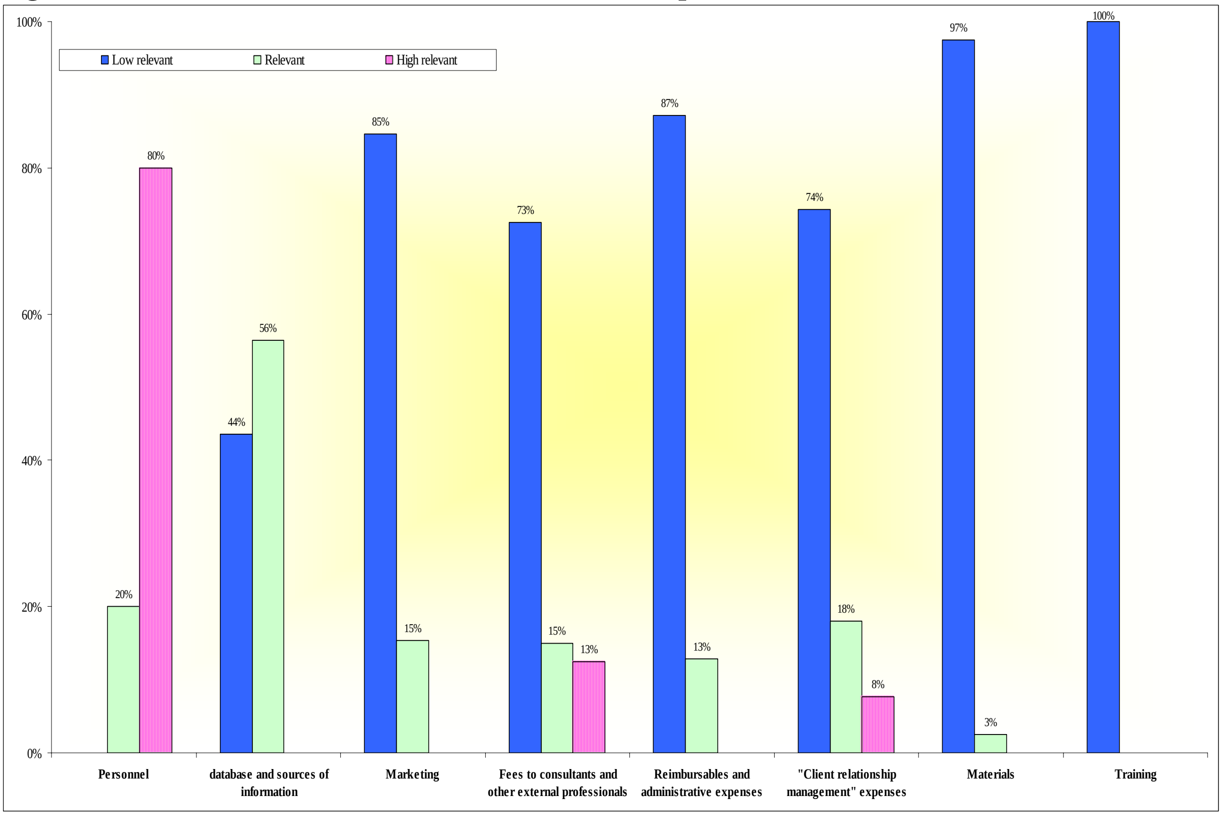
It should also be considered that lower prices could also be compensated by higher production efficiency of domestic operators with respect to foreign ones, essentially due to the just observed differences in terms of personnel dedicated to corporate finance activity. A deeper analysis is necessary on the typical cost structure characterising intermediaries in the business area of corporate finance, in order to identify those expense items that mostly affect the profitability margin generated by the business area itself.

In this respect, figure 25 not surprisingly shows that in an industry characterised by low capital intensity, a major expense item is represented by the cost of professionals involved in the "*ad hoc*" team specifically created to actualize a given transaction, followed by the cost necessary to get access to database and other sources of information, both business and financial one.[35] Payments that are made to external consultants, professionals and advisory

[34] See, in particular, Saunders, Srinivasan (2001).
[35] See note 24 for the criteria used in order to identify the different categories (high relevant, relevant, low relevant).

firms are significant as well. These third parties help to develop and complete specific phases of the bank production process because, above all for small and medium-size commercial banks, as it was mentioned in the previous section (for example, the realisation of the due diligence, the business plan, or the market analysis), it is not convenient to develop them internally.

**Figure 25. – Relevant costs in the business area of corporate finance services**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

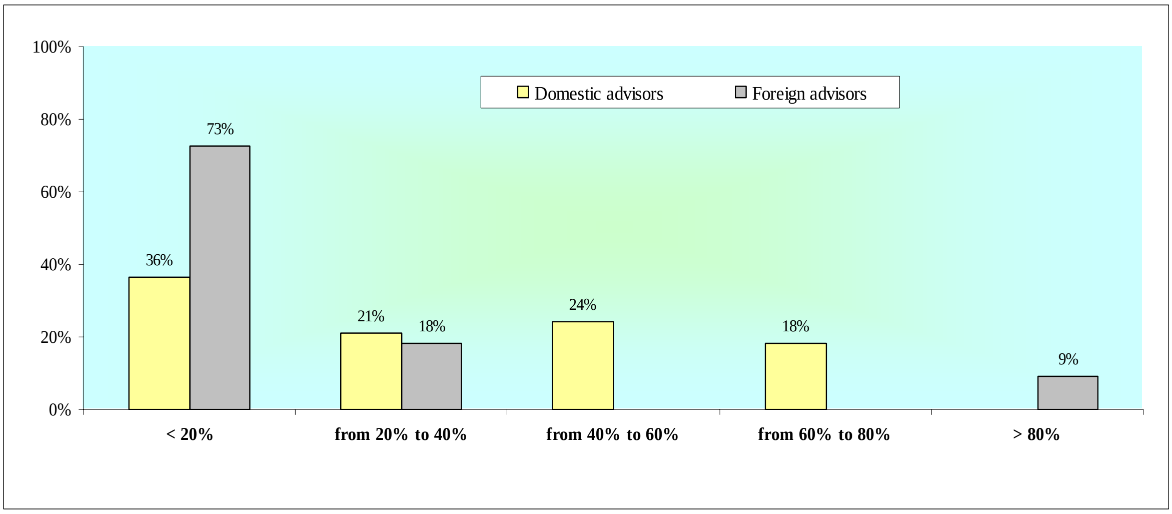
At this point, taking into consideration that, a part from the above mentioned events requiring an outsourcing strategy, the cost of internal personnel represents a typical general expense, non subject to management discretionality, it is interesting to realize that domestic financial institutions, in comparison with foreign ones, seem to be characterized by a higher average weight of variable costs over the total costs generally incurred in order to perform their operating activity (see figure 26 and 27). In particular, the 91% of foreign intermediaries present an incidence of variable costs over total operating costs lower than 40%, while only the 57% of domestic intermediaries present this same percentage value.

This result should be interpreted by keeping in mind:

a) the fact that, as it was previously noted, the percentage of professionals involved in corporate finance activity is lower for national operators with respect to foreign ones. Indeed, Italian advisors seem to be able to operate with less number of personnel and /or with less costly personnel;

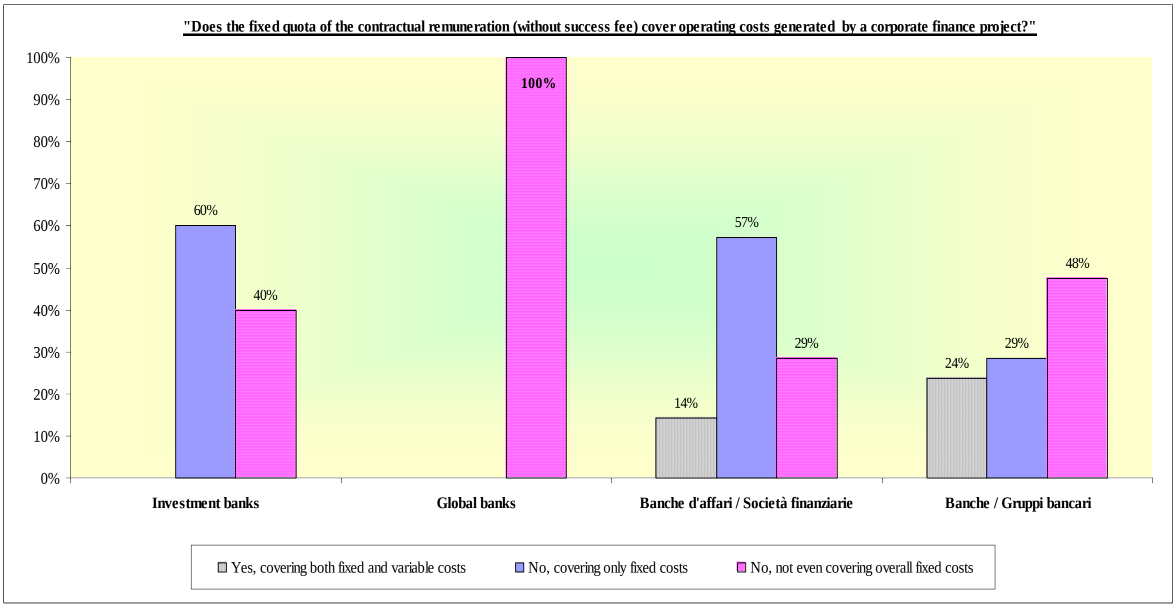
b) the fact that Italian commercial banks supply consultancy services – although, often, not explicitely remunerated – to their corporate clients as a way of keep close bank-firm lending relationships. This activity is surely less sophisticated that that potentially given by investment banks and normally is directly performe by the corporate banker. It is evident that such a relationship can generate new loans as well as corporate finance and investment banking services with doubtless advantages in terms of average unit cost of the services supplied (scale economies) and wider capability of origination for new mandates (scope economies).

**Figure 26. – Percentage weight of variable costs in the total of average costs for the development of *corporate finance* services**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

**Figure 27. – Sufficiency of the fixed part of the commission to remunerate the activity undertaken by the *advisor* in the case of an incomplete M&A operation**




*Source: DIR_Investment Banking Sample, SDA Bocconi (2004)*

Consequently Italian financial institutions undertaking corporate finance advisory activities, and above all commercial banks, seem to rely on a competitive advantage stemming not only from a superior capability to gather corporate private information, but also from higher cost efficiency and lower operational risk. These elements appear crucial in a business area characterized by high volatility of the cycle mandates-turnover-income and by high incidence of labour input, which represents the major source of fixed costs. So, as a final remark, one can say that it can be convenient to operate – like commercial banks do – with a remuneration schedule which is less focused on the achievement of a success fee in order to generate net income.

## 5. Conclusion and suggestions for future research

A common argument in the last decade deal with the significant profitability potentially available to domestic commercial banks coming from the operativity in the investment banking industry. Getting acces to this industry could be a deliberated strategic decision aimed at compensating the difficulty of generating profits from their traditional core business, represented by the joint supply of deposit-taking and lending activities.

Many studies have shown the theoretical advantages that would favour commercial banks with respect to investment banks in the development of advisory activity in order to support the actualization of a given corporate finance operation.

This work has specifically analysed the microstructure of the corporate finance services industry – a portion of the investment banking industry – with particular reference to the Italian context. The study makes reference to an empirical analysis based upon an articulated questionnaire that was sent to a sample of financial intermediaries built in a way to fully represent the market's supply side in Italy. Morevoer, the redemption rate resulted high (37,7%), allowing to consider significant the results obtained by elaborating the banks' answers to the questionnaires.

The specificity of the approach used refers not only to the research methodology adopted, with its associated strengths and weaknesses, but also to the notion of corporate finance industry chosen. According to our framework, the analysed industry extends from M&A transactions to all other typologies of operations involving changes in firm ownerhip base, including spin offs, split off, equity carve-outs, leveraged acquisitions, restructurings of distressed firms,as well as financial consulting activity.

The major results emerging from the study can be synthesized as follow.

- Corporate finance activity is relatively recent for domestic commercial banks when compared with other financial intermediaries that have been operating in this business for many decades and, therefore, can rely on wider market shares in terms both of volume and value of the transactions advised.
- Domestic advisors mainly focus on advisory services supplied to small and medium sized enterprises, thus originating small scale operations (with average unit value of around 80 million euro) in comparison with those advised by foreign *advisors* (with average unit value of around 420 million euro). To this regard, scale economies don't seem to be relevant in this business area. Furthermore, due to both the increasing advisory demand coming from SMEs and the limited value of the mandates assigned by SMEs themeselves, it is possible to forecast significant and growing opportunities in the market for domestic commercial banks.

- Consistently with initial expectations, domestic commercial banks undertake a significant volume of advisory activities aimed at supporting: entrepreneurs desiring to sell their majority equitystakes; distressed firms; corporate clients desiring to implement leveraged acquisitions. This typology of demand is highly dependent on the specific characteristics of the Italian industrial system.
- Because of the lack of a widespread distribution network, foreign operators generate their mandates on the basis of direct solicitation from the customers or from screening activities directly performed by own professionals; in any case, they greatly rely upon their reputational capital.
- Domestic operators rely on further more options to obtain mandates, basing upon either their existent bank-firm relationships generated by lending activities, or the deal flows canalized by other banks or financial firms of the reference banking group, or, again, on the relationships with other financial institutions not belonging to the same banking group. Furthermore, also relationships with consultants and tax advisors seem to be a significant source of mandates.
- Thanks to, from one side, synergies coming from lending activities and, from the other side, the outsourcing of those phases of the production process that are not economically convenient to develop internally, domestic banks and banking groups tend to utilize "lighter" structures – that is with a lower incidence of fixed costs over the total operating expenses – than investment banks do for their corporate finance activities.
- Italian financial institutions undertaking corporate finance advisory activities, and above all commercial banks, seem to rely on a competitive advantage stemming not only from a superior capability to gather corporate private information, but also from higher cost efficiency and lower operational risk.

In conclusion, the empirical analysis – despite all its limits that were mentioned – seem to support the hypothesis that commercial banks are operators particularly capable of running corporate finance activities, at least in the national context where the demand is mainly coming from small and medium size firms and is typically focused towards customized services aimed at successfully implementing ownership structure reconfigurations, such as leveraged acquisitions and turnarounds of distressed firms. Furthermore, the market's demand side seems to particularly appreciate the synergic potential stemming from the combination of lending and corporate finance activities, rather than the higher expertise and reputation gained over time by investment banks in the analysed business area, which, in turn, generally means higher unit prices.

However, the possibility to fully exploit the above mentioned business opportunitites available for domestic commercial banks imply the capability to undertake relevant strategic actions, aimed at reducing the impact of their evidenced actual weaknesses, when compared to investment banks: investing for example on the minimum amount of technical competencies required by bank professionals in order to be able to supply effective advisory services, or, again, acting in a way to improve the quality and the stability of bank-firm relationships.

Secondly, it has to be considered that taking benefit from the synergies originating from a preexistent lending relationship can potentially generate conflicts of interests that can cause the intermediary to reduce his level of objectivity in undertaking its advisory activity.

Future research should concentrate on empirically verify the real significance of these last issues, in order to check whether Italian commercial bank have been able to accept the challenge coming, on one side, from increasing competition in the financial system – that force to diversify the traditional deposit-taking and lending activity, so to defend profitability margins – and, on the other side, from the evolutionary dynamic characterizing the Italian capitalism system, still more requiring advisory interventions aimed at restructuring firms' ownership structures.

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# 7. Annexes

## A) THE DIR_INVESTMENT BANKING SAMPLE, SDA BOCCONI (2004)

| **Foreign advisors** | | **Domestic advisors** | |
|---|---|---|---|
| **Investment Banks** | **Commercial Banks** | **Investment Banks** | **Commercial Banks** |
| 3i | ABN Amro | 21 Investimenti | Banca 121 |
| Bear Sterns | Banco Santander | Abax Bank | Banca Agricola Mantovana |
| Cazenove & Co. | Bank of America | Arca | Banca Agricola Popolare di Ragusa |
| Credit Suisse First Boston | Barclays Bank | Banca Akros | Banca Antonveneta |
| Goldman Sachs | BNP Paribas | Banca Aletti | Banca Caripe |
| JP Morgan Chase Manhattan | Canadian Imperial Bank of Commerce | Banca Caboto | Banca CIS |
| Lazard Brothers | Citigroup | Banca Esperia | Banca del Piemonte |
| Lehman Brothers | Commerzbank | Banca Euromobiliare | Banca delle Marche |
| Macquarie Bank Ltd. | Credit Agricole | Banca Intermobiliare | Banca dell'Emilia Romagna |
| Merrill Lynch | Credit Lyonnaise | Banca Leonardo | Banca di Desio |
| Morgan Stanley Dean Witter | Deutsche Bank | Banca Profilo | Banca di Roma |
| NatWest | Dresdner Bank KW | BSI - Banca della Svizzera Italiana | Banca Fideuram |
| Nomura International | HSBC | Caretti & Associati | Banca Intesa |
| Rothschild | ING Baring | Cenciarini & Co. | Banca Lombarda |
| Salomon Schroeders Smith Barney | National Australian Bank | Centrobanca | Banca Popolare Commercio e Industria |
| Toronto Dominion Bank | Royal Bank of Scotland | Efibanca | Banca Popolare dell'Alto Adige |
| | Societe Generale | Finest | Banca Popolare dell'Emilia Romagna |
| | Sumitomo Bank | Interbanca | Banca Popolare dell'Etruria |
| | UBS | Investimenti Piccole Imprese | Banca Popolare di Ancona |
| | WestLB AG | La Compagnia Finanziaria | Banca Popolare di Bari |
| | | Livolsi & Partners | Banca Popolare di Bergamo - CV |
| | | Mediobanca | Banca Popolare di Brescia |
| | | Mediocredito Centrale | Banca Popolare di Intra |
| | | Meliorbanca | Banca Popolare di Lodi |
| | | Palladio Finanziaria | Banca Popolare di Milano |
| | | Simest | Banca Popolare di Sondrio |
| | | Sopaf | Banca Popolare di Verona e Novara |
| | | Tamburi & Associati | Banca Popolare di Vicenza |
| | | Vitale & Borghesi | Banca Popolare Friuladria |
| | | | Banca Sella |
| | | | Banca Toscana |
| | | | Banco di Napoli |
| | | | Banco di Sicilia |
| | | | Banco di Sardegna |
| | | | BiverBanca (Gruppo Banca Intesa) |
| | | | BNL |
| | | | Carige |
| | | | Carisbo |
| | | | CR Alessandria |
| | | | CR Asti |
| | | | CR Bolzano |
| | | | CR Cento |
| | | | CR Ferrara |
| | | | CR Firenze |
| | | | CR Parma e Piacenza |
| | | | CR Pescara |
| | | | CR Ravenna |
| | | | CR Rimini |
| | | | CR Torino |
| | | | Credito Emiliano |
| | | | Gruppo Unicredito |
| | | | Mediocredito del Friuli Venezia Giulia |
| | | | Monte dei Paschi di Siena |
| | | | RAS Bank |
| | | | San Paolo-IMI- Cardine |
| | | | Unibanca |
| | | | Veneto Banca |

B) THE QUESTIONNAIRE[36]

# Questionnaire

## GENERAL INFORMATION

- Business name ______________________________
- Business Location ______________________________
- Banking Group ______________________________
- Size *(total consolidated assets)*
  <5 bill. € from 5 to 20 bill. € from 20 to 50 bill. € >50 bill. €
- Main source of funds raised *(indicate only one answer)*:
  deposits bank loans securities and bonds equity
- Geographical area of reference ______________________________
  *(Indicate the region/s where you have the most corporate clients)*
- Specify which of the following investment banking services are more often required by firms, pointing out which of them are directly performed by your company and which are performed by other members of the banking group.

| *(no more than 5 choices)* | Financial service more frequently requested by firms | | Service performed: | |
|---|---|---|---|---|
| | **with less than 250 employees** | **With more than 250 employees** | **Directly by the bank** | **By another bank of the group** |
| Assistance for equity participation by third parties in the private equity market | | | | |
| Restructuring corporate ownership base | | | | |
| Managing the transfer of the controlling interest | | | | |
| Placement of stocks in the market | | | | |
| Placement of bonds in the market | | | | |
| Assistance for mergers/acquisitions | | | | |
| Assistance for split/spin-off | | | | |
| Assistance for leveraged buy-out | | | | |
| Financial advisory | | | | |
| Tax advisory | | | | |
| Assistance for extrajudicial resolution of company distress | | | | |
| Assistance for restructuring of existing financing | | | | |
| Assistance for project financing | | | | |
| Investment management | | | | |
| Private banking | | | | |
| Risk management | | | | |
| Other (please specify) | | | | |

[36] A part from the "General Information" section, is presented only that section of the questionnaire – the "Corporate Finance" one – whose results have been being elaborated in this paper by the author. The other sections of the questionnaire take explicitely in consideration the other investment banking's business areas (namely, "Project Financing", "Capital Markets", "Merchant Banking", "Risk Management") and will be analysed in other forthcoming papers.

*(Fill out only if the company is not directly involved in one or more of the following areas)*

Indicate the name of the bank or the company in the group to whom the services are transferred:

- *CORPORATE FINANCE* ____________________
- *PROJECT FINANCING* ____________________
- *PRIVATE EQUITY* ____________________
- *FINANCIAL MARKETS* ____________________
- *RISK MANAGEMENT* ____________________

…………………………………

## SECTION 1 – *CORPORATE FINANCE* AREA

*(FILL IN ONLY IF THE BANK DIRECTLY OPERATES IN THIS AREA)*

**Market trend**

Indicate the business evolution in the last five-year period in terms of:

- number of extraordinary financial transaction followed as *advisor*:

1999 ________ 2000 ________ 2001 ________ 2002 ________ 2003 ________

- volume of extraordinary financial transactions followed *(in million euros)*

1999 ________ 2000 ________ 2001 ________ 2002 ________ 2003 ________

- number of finished financial consulting projects (concerning distressed and healthy firms)

1999 ________ 2000 ________ 2001 ________ 2002 ________ 2003 ________

- share of the commissions and revenues produced by *corporate finance* business *( % of revenues from services)*

1999 ________ 2000 ________ 2001 ________ 2002 ________ 2003 ________

- number of employees dedicated to *corporate finance* business *(in % as regards to the total number of employees)*

1999 ________ 2000 ________ 2001 ________ 2002 ________ 2003 ________

- Indicate, ordering by importance, the five sectors having the most transactions *(food, textile, chemicals ,constructions, distribution public administration, , …)*

1. ____________________
2. ____________________ *(1 =very important, 5 = not very important)*
3. ____________________
4. ____________________

## FEATURES AND CONTENTS OF THE INVESTMENT BANKING AREA

In which of the following transactions/services is the bank most often involved as *advisor*?
*(You must answer no more than 3)*

- ☐ Acquisitions (from seller)
- ☐ Acquisitions (from buyer)
- ☐ Mergers
- ☐ Demergers
- ☐ Spin-offs
- ☐ Joint-ventures
- ☐ Restructuring ownership
- ☐ Reorganization of business
- ☐ Leveraged acquisitions
- ☐ Financial advising

- Indicate in order of importance the most direct competitors of the bank in offering *corporate finance* services *(1 = very important, 5 = not very important)*
  1. ___________________________________
  2. ___________________________________
  3. ___________________________________
  4. ___________________________________
  5. ___________________________________

- Which of the following phases of the functions performed by the *advisor* is the most important? *(Ranking" column: 1= most important, 9= less important)*. Highlight for each phase, the relative position of the bank with respect to its competitors *(Select only one of the columns of "competitive positioning" options).*

| **Phases** | **Ranking** | **Competitive positioning** | | | |
|---|---|---|---|---|---|
| | | **Outstanding** | **Average** | **Below avaverage** | **Phases not directly developed** |
| Origination | | | | | |
| Market analysis | | | | | |
| Business plan and financial valuation | | | | | |
| Structuring transaction | | | | | |
| Contractual Process | | | | | |
| Syndication | | | | | |
| Due diligence | | | | | |
| Implementation of transaction | | | | | |
| Assistance post-transaction | | | | | |

- With reference to the "origination" phase of transaction, which are the modalities to obtain the mandate for the assistance to the corporate clientele?
  - ☐ Request generated from a direct solicitation of the enterprise;
  - ☐ Request generated from the enterprise's advisor;
  - ☐ Request generated from the bank;
  - ☐ Request generated from a pre-existing financial relationship;
  - ☐ Request generated from the parent company or from another bank of the Group;
  - ☐ Request generated from a bank or another intermediary apart from the Group.

- Are there professionals dedicated to the execution of the origination phase?
  - ☐ Yes
  - ☐ Yes, but they manage all relations with the corporate clientele (“corporate managers”).
  - ☐ Yes, the person in charge of it is the branch manager
  - ☐ No.

- Indicate the importance of each of the following factors in the choice of the advisor by the enterprise *(1 = not very important, 6 = very important)*

| | | | | | | |
|---|---|---|---|---|---|---|
| - Reputation in service’s area of *corporate finance*. | 1 | 2 | 3 | 4 | 5 | 6 |
| - Long term relationship | 1 | 2 | 3 | 4 | 5 | 6 |
| - Structure of the proposed remunerations | 1 | 2 | 3 | 4 | 5 | 6 |
| - Professionalism and discretion recognized of the bank | 1 | 2 | 3 | 4 | 5 | 6 |
| - Consultancy expertise demonstrated by the bank | 1 | 2 | 3 | 4 | 5 | 6 |
| - Extent and depth of financial and business competencies | 1 | 2 | 3 | 4 | 5 | 6 |
| - International network with other financial intermediaries | 1 | 2 | 3 | 4 | 5 | 6 |
| - Potential synergies between consulting activity and financial activity | 1 | 2 | 3 | 4 | 5 | 6 |
| - Others (please specify) …………………….................................. | 1 | 2 | 3 | 4 | 5 | 6 |

- The division in charge of the execution of the operation/service of corporate finance:
  - ☐ is a permanent structure in the field of the bank;
  - ☐ is a professional team temporarily dedicated (also apart from corporate finance services);
  - ☐ is an external structure, that is delegated to the service’s realization (but not the supply) in an outsourcing logic;
  - ☐ is almost completely based on the originator of the operation (who operates autonomously and decides the allocation of resources).

- Which of these competencies are outsourced? *(you may select more than one)*

| | | |
|---|---|---|
| ☐ Tax | ☐ Legal | ☐ Quantitative |
| ☐ Macroeconomics | ☐ Technological | ☐ Financial |
| ☐ Sectoral | ☐ Managerial | ☐ Accounting |
| ☐ Relational | ☐ IT related | ☐ Linguistic |

- Does the bank have a team of professionals with expertise in the preparation of *business plan* and financial valuations (*based on the discounted cash flow analysis)* for the execution of corporate services?
  - ☐ No, these techniques are not used in the bank;
  - ☐ Yes, limited to the people in charge of credit appraisal.
  - ☐ Yes, at every level.

- How do you acquire the senior resources responsible for the realization and execution of corporate finance transactions?
  - □ Resorting to professionals with a confirmed experience with other financial intermediaries;
  - □ By training internally the employees suited to this kind of activity;
  - □ Resorting to professionals with a confirmed experience in the credit appraisal;
  - □ Resorting to professionals in the bank with a significant experience, independently of the typology of the activity .

**PROFITABILITY OF BUSINESS AREA**

- Which of the following costs weigh more on the profitably of *corporate finance* structure? *(1 = low importance; 6 = high importance)*

| | | | | | | |
|---|---|---|---|---|---|---|
| - Cost of employees | 1 | 2 | 3 | 4 | 5 | 6 |
| - Costs of database/sources | 1 | 2 | 3 | 4 | 5 | 6 |
| - Marketing/communication expenses | 1 | 2 | 3 | 4 | 5 | 6 |
| - Payments to the consultants and other external professionals | 1 | 2 | 3 | 4 | 5 | 6 |
| - Repayments of current expenses (travel, hotels, food, …) | 1 | 2 | 3 | 4 | 5 | 6 |
| - Expenses to build the relation with the clients | 1 | 2 | 3 | 4 | 5 | 6 |
| - Purchases (books, stationery...) | 1 | 2 | 3 | 4 | 5 | 6 |
| - Others (please specify) ……………………………… | 1 | 2 | 3 | 4 | 5 | 6 |

- Which is the weight of variable costs requested for the planning and the execution of a operation/service of corporate finance as a percentage of total costs?

  □< 20%; □ from 20% to 40%; □ from 40% to 60%; □ from 60% to 80%; □ > 80%

- Is the fixed part of the fee sufficient to compensate the supplied services if the success fee is not achieved?
  - □ Yes, because, in every case it covers the fixed and the variable costs sustained;
  - □ No, because it is only just sufficient for the covering of fixed costs;
  - □ No, it doesn't cover the fixed costs, because the service is provided in the context of the overall client relationship..