EVALUATION OF THE ITALIAN “START-UP ACT”

An effective policy is a first step toward a more supportive ecosystem for innovative start-ups

Enabling start-ups to enter the market and grow is a policy priority across most OECD countries. In 2012, Italy introduced a new policy framework aimed at creating a more favourable environment for innovative start-ups through a number of complementary instruments, including digital and zero cost incorporation, simplified insolvency procedures, tax incentives for equity investments, innovative regulations on equity crowdfunding, and a public guarantee scheme for bank credit.

Given that only a tiny proportion of new firms eventually grow, policy makers face two alternatives in their approach to innovative start-ups: targeting specific firms predicted to be highly innovative in the future, or fostering experimentation among firms and streamlining both entry and exit. The Italian “Start-up Act” combines these two approaches with an eclectic mix of policy tools along with specific eligibility criteria targeting start-ups with innovation potential.

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The quick read

A recent OECD report (Menon et al., 2018) provides an independent and comprehensive evaluation of the Italian “Start-up Act”, the policy framework for innovative start-ups introduced by the Decree-law 179 in 2012. The policy aims at creating a more favourable environment for small innovative start-ups through the activation of 19 complementary instruments, including digital and zero cost incorporation, simplified insolvency procedures, tax incentives for equity investments, a public guarantee scheme for bank credit, crowdfunding regulation, and a start-up visa programme. Given the recent nature of the programme, this evaluation aims to provide an early assessment of the impact of the policy on beneficiary firms and on the entrepreneurial ecosystem in Italy.

The evaluation combines a number of different methodologies and data sources. A counterfactual analysis based on detailed balance-sheet, patent, and bank credit data at the micro level estimates the causal effect of the policy on the beneficiary firms using a wide set of different outcome variables. The results indicate that the “Start-up Act” has had a sizeable positive effect on both the inputs and the outputs of the beneficiary firms. In particular, the policy has induced firms to increase their revenues, value added, and assets by about 10-15%, relative to similar start-ups that do not benefit from the policy, or benefited at a later stage. The empirical analysis also shows that enrolled firms are more likely to receive credit from banks. In addition, the policy appears to be robustly correlated with a higher probability of receiving VC funding. However, the positive effects at the firm level do not appear to translate yet into a significantly higher volume of VC investments at the aggregate level. The report concludes that a number of further “horizontal” policy actions – beyond the scope of the specific programme evaluated by the OECD – are needed in order to create a favourable start-up ecosystem in Italy.
Eligibility criteria and instruments

The Italian “Start-up Act” is an extensive regulatory framework providing support to innovative entrepreneurs across all sectors until the fifth year of activity since incorporation. Based on a voluntary, opt-in mechanism, this policy stands out in international comparisons as it includes an entire bundle of policy instruments (19 individual tools). These include policies which cut red tape and facilitate entry and exit to the market, including an online-based, zero cost procedure for incorporation; tax relief for equity seed- and early-stage investors; flexible regulations on fixed-term contracts; “fast-track”, free-of-charge access to a public guarantee facility for debt finance; the right to raise capital through equity crowdfunding campaigns; a “start-up visa” scheme for non-EU tech entrepreneurs; etc.

The “Start-up Act” defines a set of eligibility criteria to identify start-ups that are expected to be innovative firms: the company should be operational for less than five years, be headquartered in Italy or in another EU country, have an annual turnover below five million euros, not be the result of a branch split or merger from a previous company, have a statutory mission explicitly related to innovation, be a limited company and not publicly listed, and should not have distributed profits. Furthermore, firms need to meet at least one of the following three criteria: at least 15% of company expenses should be attributed to R&D activities; either one-third of employees are PhD students or graduates or researchers, or two-thirds hold a Master’s degree; and, being the holder, depository or licensee of a patent, or owner/author of registered software. Available evidence suggests that these rules are generally effective in detecting firms that on average are more innovation-oriented.

The policy has a positive impact on enrolled firms

The overall evidence on the initial effects of the “Start-up Act” is positive, also in light of its relatively modest cost (estimated at approximately EUR 30 million for the period 2013-16). The counterfactual analysis shows that the policy leads to significant effects both at the input and output side. The magnitude of the estimated causal effects is sizeable: e.g., the policy allows firms to increase their revenues, value added, and assets by about 10-15%, relative to similar start-ups that did not benefit from it, or benefited at a later stage. Figure 1 shows that the effect materialises in the first year of enrolment into the policy and stay roughly constant afterwards. Access to credit via the public guarantee fund also significantly increases the magnitude of the effects.

The analysis also identifies significant heterogeneous impacts depending on whether start-ups rely on equity or debt. On the one hand, firms backed by the credit guarantee scheme indicate evidence of credit constraints. Thanks to the public guarantee scheme, access to bank debt improved: firms obtained more credit (e.g. the net flow of loans increased by around 14 percentage points) at a lower interest rate. As a result, their investment rate increased markedly. On the other hand, firms that did not use the credit guarantee scheme benefit from other measures of the “Start-up Act”, which allowed them to reduce their equity gap. Rather than raising leverage, they significantly increased their net worth. These improvements in the financing conditions of equity-backed firms were coupled with an increase in value added, labour productivity, and patenting of a similar magnitude than those of the guarantee-backed firms, while the former accumulated a smaller amount of capital.

There are some encouraging signs from the VC market

The policy also appears to be positively linked with a number of broader outcomes, including an increase in VC deals. The analysis shows that firms that registered into the policy were more than twice as likely than firms not registered in the policy to receive VC financing, within the first three years since the start-up has been founded. However, the total amount of VC investments in Italy does not appear to have increased significantly since the implementation of the policy, especially compared to the growth trends in other EU countries of similar size. To address this issue, further policy actions may be required both “upstream” at the investment phase, where the lack of a critical mass of investment appears evident; and “downstream”, in order to foster the domestic demand of innovative goods and services produced by start-ups, and therefore make innovative start-ups more attractive for investors.
Further efforts are needed to improve the start-up ecosystem in Italy

While direct policy interventions are important to encourage entry, growth and dynamism, further horizontal structural reforms are needed to ensure an overall business environment conducive to entrepreneurship. Policy bottlenecks that are generally detrimental for all businesses can be particularly harmful for small start-ups. There are many examples of “horizontal” policy areas in Italy that still have room for improvement in order to create a better business environment for innovative start-ups. These include, inter alia, contract enforcement, bankruptcy and insolvency, education and skills, telecommunication infrastructure, and utilisation of digital technologies.

Broader policy recommendations

In Italy, the balance of support for equity versus debt financing needs to be carefully considered. While the large majority of start-ups in the policy that accessed the public guarantee fund for bank loans appear to benefit substantially from it, the economic literature suggests that equity financing is more suited to high-growth and high-risk innovative start-ups.

Several specific findings from the analysis of the policy point to directions for possible future improvements, including:

- The eligibility criteria could be further refined and fine-tuned in order to increase the impact of the policy by targeting funding on the set of start-ups that is most in need of policy support.
- Actual and potential entrepreneurs should be fully aware that the ecosystem has become supportive, and high-potential start-ups should become more visible to investors. A more impactful communication strategy may give innovative entrepreneurship a more central place in the Italian policy debate. Compared to other OECD countries, innovative start-ups in Italy appear to suffer also from a “cultural” bias against innovation and a lack of advocacy in the public debate.
- Innovative entrepreneurship should be accessible to “outsiders”, for example female, young, and foreign entrepreneurs. Entrepreneurship can act as a powerful engine of social mobility and inclusiveness, something that is particularly needed in Italy. The policy framework already contains some important instruments in this context – like e.g. the “start-up visa” for non-EU entrepreneurs – and further tools could possibly be considered.
- The need for further public investments in VC should be assessed, e.g. by exploring a bolder commitment and sponsorship of existing and newly-established government-backed matching funds and funds-of-funds, particularly beyond the “angel” segment and the “seed” and “early” stages.

Notes: The graphs report the average effect of the policy for each year since registering into the policy. An estimated effect equal to 0.1 corresponds approximately to a 10% increase in the dependent variable. The excluded baseline category includes years earlier than the year before entering into the policy. The red whiskers report 90% confidence intervals.
Further reading


Website


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Please cite this note as: