"Creative destruction" or "destructive creativity"? Italian firms' approach to industrial failure and surviving strategies, 1920s-1970s

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Introduction

Bankruptcy and insolvency are common features of dynamic economies, very often revealing problems of fraudulent behaviour and managerial ineptitude. Companies' insolvency, however, can also be linked to exogenous crises and structural change. External shocks depress demand, reduce expectations and worsen financial instability, turning profitable business into fragile concerns. The same can happen as a result Schumpeterian "creative destruction" when the adaptation capability of the industrial structure is put under severe stress.

Under these two different circumstances, not all firms experiencing difficulties are inefficient and must be necessarily eliminated. This will in fact result into undue dissipation of a patrimony of entrepreneurial skills and information. In order for an economic system to prosper it is therefore necessary to be able to accommodate the impact of macroeconomic shocks or technological change letting structurally inefficient companies to go and giving worthy businesses the possibility to restart.

In market systems this capability is embodies in that set of laws, enforcing mechanisms, and procedures generically known as bankruptcy (or insolvency) legislation.

The aim of this study is to analyse the way in which Italian insolvency legislation dealt with these problems. Despite the literature on Italian industrial history being rich,[2] this important aspect failed to attract scholars' attention. This paper is the first and still provisional result of an ongoing research aiming at filling this gap. This study is based on both quantitative and qualitative sources. The former consist of macro national data about number of cases involved in various procedures between 1900 and 1980. Information about insolvent companies in Milan and its province during the 1920s and the 1950s constitutes the bulk of qualitative sources. Being Milan and the province the most important industrial

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[2] For up-to-date survey, see R. Giannetti and M. Vasta, 2006

area of the country, this case study can be considered as well representative of the national context.

The paper is structured as follows: section I provides the analytical framework looking at the way in which insolvency and bankruptcy law impact on the economic activity. Section II analyses the evolution of the various legal instruments available in Italy in different periods, and it compares them to contemporary insolvency laws and procedures in England and the US. Section III provides a quantitative overview of the phenomenon. Section IV and V run a qualitative analysis, comparing the way in which insolvency was addressed in phases in which different instruments were available (the 1920s and the 1950s). Section VI provides some concluding remarks.

I. Institutional mechanisms: the importance of bankruptcy legislation and procedure.

Insolvency and bankruptcy laws and procedures play in many ways a fundamental role in market economies. By fixing the cost to be paid in case of failure, these institutions represent the most direct measure of entrepreneurial risk. *Ex-ante*, a very strict legislation would therefore discourage the exploration of innovative businesses or whatever activity characterised by high risk but also by high returns. However, a stringent set of normative would also discourage frauds or in general ultra-risky behaviour, while a soft one would produce the opposite result. Reaching the correct balance among harshness and softness, in order to deal with those opposite issues, is thus one of the aims of efficient insolvency legislation.

A similar trade-off also appears when legislation has to deal with *ex-post* issues. When insolvency occurs, creditors want to recover as much as possible and as soon as possible, therefore procedures should be fast and cheap. The problem with this approach is that fast procedures leave little room for a deep investigation of the reasons why a given company or entrepreneur went bankrupt. In fact, enquiring into the causes of companies' distress is useful in order for insolvency procedures to perform another fundamental duty, the one of selecting among failed debtors or companies. Insolvent business can be of very diverse types. Firstly, debtors may be structurally insolvent or just temporary illiquid, and the treatment of the problem should be different in these two cases. Also, even structurally insolvent businesses are not necessarily in such conditions because of fraudulent behaviour or incompetent management, but also because of the impact of external shocks; again these are two different problems requiring different cures.

Being able to select correctly among different categories of debtors and insolvent companies is the first step to address the issue of avoiding unnecessary exits from the market. It is clear that in many cases it is convenient to keep firms as ongoing concerns rather than liquidating them. This is true both at micro level (a good company is a patrimony of skills, information, and knowledge which should not be wasted) as well as at macro level, as failures can easily trigger "domino-effect". However, if unconditional liquidation constitutes an unnecessary cost for the economic system, giving any debtor or any company an easy opportunity to restart can have serious consequences both *ex-post* (there will be no selection in the firms population) and *ex-ante* as this will encourage ultra-risky behaviour and speculative attitude. A good legislation should therefore first guarantee a reliable selection among companies, and second to ensure that fraudulent and/or incompetent managers or entrepreneurs would find it hard (or even impossible) to restart their original business, while good debtors should be given an easy "fresh start". This role can be plaid in two non mutually-exclusive ways. Firstly, selection itself provides a "signal" to the market, indicating which manager, company, or entrepreneur deserves future financial support, provision or row materials, supply of services, etc., in other words not be cut off business. Ideally, on top of the "signal", the law should also provide "restarting devices" to guarantee firms continuity. Examples of theses instruments are debt-discharge for personal entrepreneurs, friendly agreements alternative to liquidations, direct intervention of public bodies, provision and enforcement of specific contracts to ease financial restructuring.

II. Italian legal instrument in comparative perspective

During the historical evolution of bankruptcy and insolvency laws and legislations, the way of addressing the two issues of selecting among debtors and to foster business re-starting, took different forms in various countries. Before turning our attention to the Italian case, it is worth to consider other experiences in order to put the Italian system in perspective. In general, it has been argued that common law countries benefited from a more relaxed approach to bankruptcy and insolvency and, as a consequence, legislations were more oriented towards the principle of saving firms from liquidation. On the contrary, Continental Europe legislations, in particular the French tradition to which the Italian law

belonged, maintained a much more punitive attitude, providing relatively more creditors-oriented procedures.[3] A comparison between Italy, the US, and England supports this view.

In the US corporate insolvency legislation was shaped by the 1880s railways crisis. At that moment the US did not have any national law yet, therefore the emergency was solved by a direct intervention of the judicial system which, supported by the government, acted to avoid massive liquidation and to ensure companies' restart. Courts *de facto* invented and subsequently enforced new forms of contracts which provided strong incentives for creditors (in particular small creditors) to remain onboard companies to be restructured. Specifically, courts gave the right to companies under receivership (a procedure aimed at dealing with day-by-day management, as well as providing a restructuring plan) to issue new securities to take the place of the old stocks. Creditors could choose to swap old shares with new securities (therefore keeping a share of the property of the company to be restructured) or to abandon the company and to return old stocks in exchange for cash. Courts had the right of setting the amount of cash that could be claimed (the so-called "upset price") by dissatisfied creditors. The "upset price" level determined the convenience to abandon or support companies under restructuring. As courts made sure to put upset prices very low in order do disincentive creditors to rush for money, the American procedure became a very efficient system to avoid liquidation and to keep business as ongoing concerns.[4] The system invented *ad hoc* to solve railway companies' crises progressively became the rule. American insolvency law, eventually codified in the 1930s,[5] therefore operated quite directly as a restarting device; in a sense the "signal" effect was not even needed as creditors simply had more incentives to stay onboard companies than to leave them.

In England corporate insolvency has been originally disciplined by the Companies (winding-up) Act of 1890[6]. The law allowed three kinds of liquidation: voluntary, compulsory, and supervised. This structure already provided an automatic "signal" to the market as different forms of liquidation were conceived to address different forms of problems. In particular voluntary liquidation was *de facto* allowed only to solvent companies.[7] On top of the "signal" effect, the English law also provided instruments explicitly conceived to re-start companies and avoid liquidation. In case of voluntary wind-

[3] Di Martino, 2004.
[4] Tufano, 1997.
[5] Skeel, 1997.
[6] 53 & 54 Vict., c.63 (1890).
[7] Insolvent companies could file for voluntary liquidation but creditors had the power to appeal to the court to have voluntary liquidation to be turned in a court-supervised procedure. See Gore-Browne, 1925.

up, a legal device known as "company restructuring" offered companies the opportunity to re-start via a procedure similar to the American receivership. Otherwise, a court-sanctioned agreement with creditors, even without eliminating the old company and creating a new concern, represented another way to solve the problem of re-launching a business in liquidation. Similarly to what happened in the US, in England the problem of enforcing dissident creditors to join the restructuring plan emerged, but specific norms and procedural devices addressed it.[8]

In Italy corporate insolvency[9] was addressed using two basic instruments; assets liquidation and distribution of dividends among creditors (*fallimento*) and judicial agreements with creditors after the beginning of insolvency procedure (*concordato fallimentare*). Attempts to provide alternatives to avoid unnecessary business liquidations took place since the early 1880s, when a new commercial code was provided. In that context, a device called *moratoria* (moratorium) was offered in order to deal with worthy debtors. This instrument, however, remained a pure theoretical option, as it allowed only debtors whose assets exceeded liabilities to file for it. A further attempt to solve the problem was made in 1903 when friendly agreements between debtors and creditors supervised and approved by courts (*concordato preventivo*) became legal. In theory one of the aims of the new legislation[10] was to avoid unnecessary liquidations by giving the possibility of reaching an agreement before the actual insolvency procedure took place. In practice, however, the instrument had very serious limits at this regard. First, in order for a *concordato preventivo* to be approved, debtors should guarantee the payment of at least 40% of all unsecured debts. This sort of pre-condition was rather common in other legislation, but in no other country the limit was so high and, as a consequence, *concordato preventivo* found relatively little usage.[11] In conjunction with this issue, debtors were legally impeded to transfer the creditors the whole assets together (the so called *cessione d'attivo*). The legal impossibility of the *cessione d'attivo* combined with the high level of debts to be paid, meant that most *concordati preventivi* ended-up with liquidation; in other

[8] For example in case of restructuring dissident creditors had only one week to refuse the deal, while in the case of agreement a majority of three quarters of creditors was enough to approve the plan. Gore-Browne, 1925.

[9] The same law dealt with personal bankruptcy. For this reason in the Italian legal jargon the difference between (corporate) insolvency and (personal) bankruptcy disappears, both words being used as synonyms. In order to avoid improper translation and confusion, we indicate Italian legal instrument using their original Italian names.

[10] *Concordato* was also conceived to be a generically milder procedure reserved to worthy debtors and companies. In fact, *concordato* did not have all the heavy legal consequences, as well as the social stigma, associated with *fallimento*.

[11] Di Martino, 2005.

words *concordato preventivo* was not a viable alternative to liquidation and therefore a very poor direct solution to the problem of firms re-start. However, as noticed above, conditions to reach *concordati* were very strict and therefore in theory the signal given to the market quite strong. This was true only to an extent. In fact courts' approval was only partially motivated on technical bases; the idea was to support the mythical "honest but unlucky" debtor, rather than to select firms and debtors applying to *concordato* in terms of current and future viability.

The inability of *concordato* to be a real alternative to liquidation was dramatically exposed during the early 1920s in conjunction with the crisis of the *Banca Italiana di Sconto* (BIS). In order to solve that crisis, the legislator re-introduced the *moratoria,* initially for the specific case of the BIS and lately for a wider set of financial companies, banks, and insurances.[12] However, a general solution to the problem of insolvency of industrial firms was still missing. It was only in 1942 that Italian law-makers eventually provided a new instrument specifically conceived to offer worthy firms a credible alternative to liquidation: the so-called *amministrazione controllata*.[13] *Amministrazione controllata* allowed companies experiencing difficulties to avoid *fallimento* and keep on operating for one year under the guidance of a new management whose members were chosen among public officers. As a concept *amministrazione controllata* was not dissimilar to the *moratoria* but, in practice, had the advantage of transferring managerial power in the hands of someone completely external to the company. In doing so, the *amministrazione controllata* avoided the risk that the "suspension" year was used to save the owner's wealth or the managers' reputation, rather that the look for a solution to the company's crisis. In terms of conditions to file for it, *amministrazione controllata* was rather strict, therefore it was a good instrument to give the market a signal about management honesty; a company under *amministrazione controllata* was a company whose distress was not caused by fraudulent behaviour. However, as for *concordato*, court's approval did not depend upon an analysis of technical competences and managerial ability. Therefore there was no guarantee that managers of a company under *amministrazione controllata* were not only "honest but unlucky", but also competent.[14] Even more remarkably, *amministrazione concordata* had limits also in terms of being a good "restating device". In particular this institution did not

[12] Di Martino, 2004.
[13] R.D.L. 16/03, n. 267. In the same period also the use of the so-called *liquidazione coatta amministrativa* was extended to all kind of business. *Liquidazione coatta amministrativa*, however, was not an intrument to guarentee firms' survivor and simply implied that official bodies were in charge of assets liquidation
[14] For details, see Bonsignori, 1986.

contemplate any specific instrument to solve the crisis, other than the fact that problems would have been solved in one year by a different management. If this was not the case, solutions were simply *concordato* or *fallimento*. Contrary to the American procedure, the law created no incentive for investors to re-capitalise the company and to give it a real "fresh start". On top of this problem, there was the issue that courts' decisions about allowing the *amministrazione controllata* did not imply any assessment of the future viability of companies.[15] In practice, not only the institution did not lock-in reluctant investors, but also did not even give any useful information to the ones that could be tempted to re-invest in the company.

The problem of constraining reluctant creditors did not disappear in case of voluntary wind-up of solvent companies. The Italian law left open the possibility of finding agreements with creditors but did not explicitly contemplate a link between liquidation and restructuring and, in particular, did not provide any legal device to constrain the behaviour of dissident creditors.

To sum-up, the Italian legislation seems to have had serious limitation in terms of instrument to guarantee companies' continuity, both in terms of allowing insolvent business alternative to *fallimento*, and to give solvent firms incentives to restructuring. In the next three sections we will test this hypothesis using both quantitative and qualitative evidence.

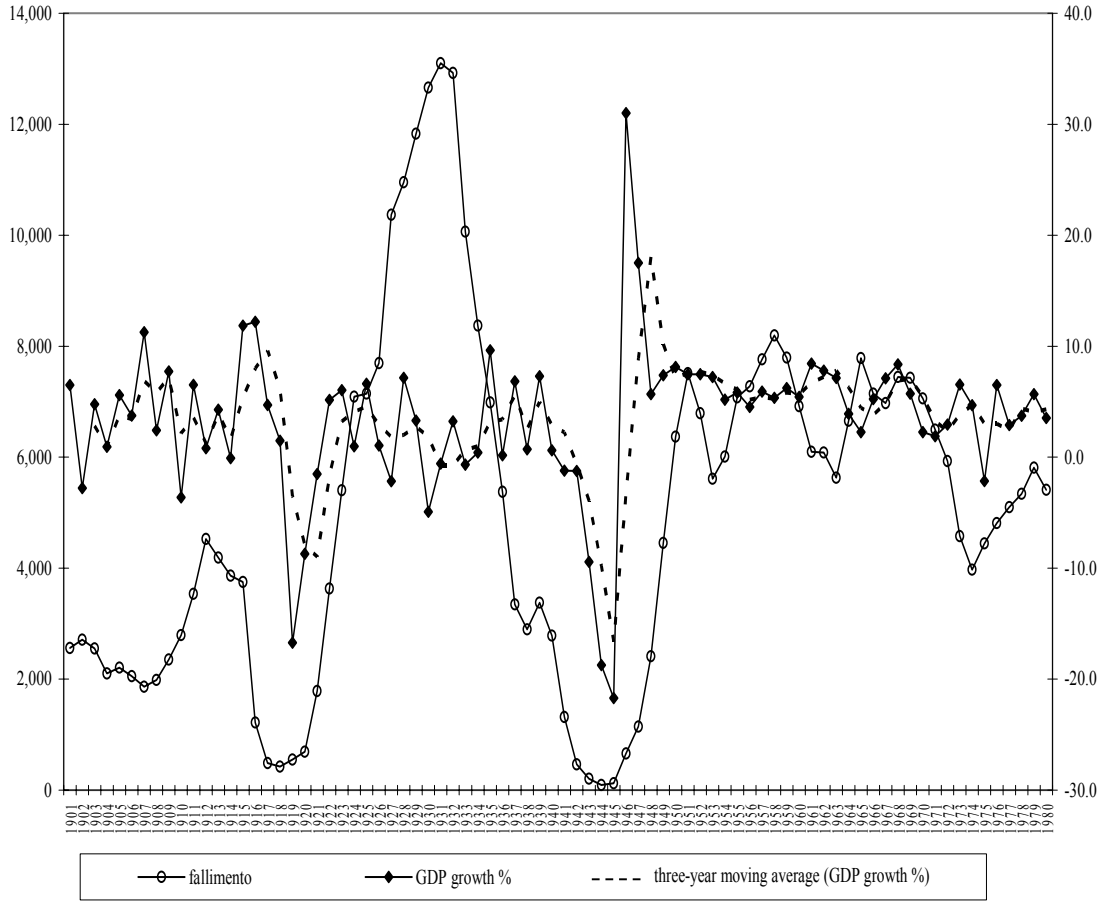
III. Quantitative overview

In order to give a general overview of the diffusion of various legal procedures, in this section we analyse the relative significance of different alternatives – *fallimento* (including *concordato fallimentare*), *concordato preventivo* and *amministrazione controllata* - that companies can adopt when facing insolvency problems.

The first result that emerges from the data analysis concerns the relationship between the number of *fallimenti* and economic growth, as fig. 1 shows. The he existence of a inverse correlation between these to variables, according to which during the downturn of the economic cycle the number of *fallimenti* should grow, is not confirmed. Even using a three-year moving average for GDP's fluctuation, which removes the bias due to time discrepancy between worsening economic conditions and the actual beginning of the insolvency problem, there is no evidence of such a correlation.

[15] Bonsignori, 1986.

Fig. 1. Number of *fallimenti* and GDP % annual growth (1901-1980)



Sources: our own elaborations on Istat, *Annuario delle statistiche giudiziarie* [various years].

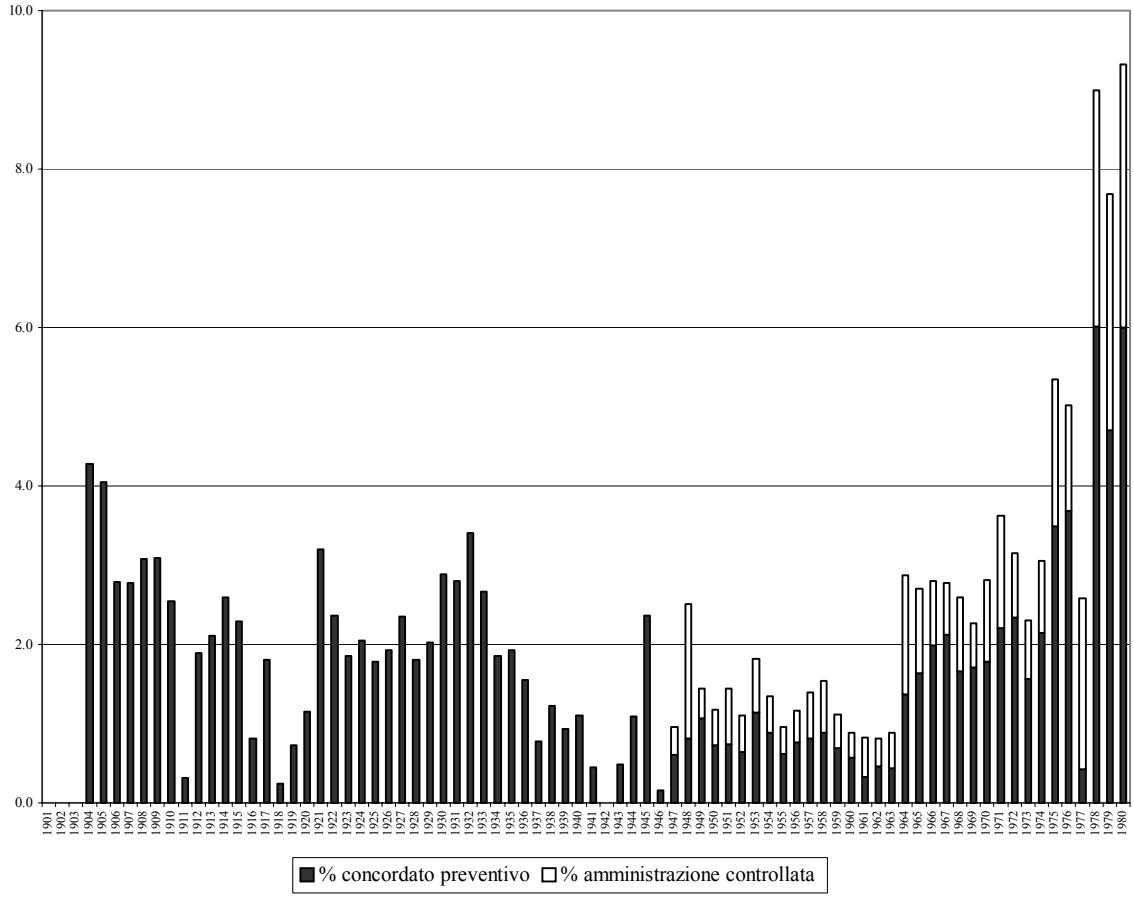
The number of *fallimenti* reached the peak during the big crisis of late Twenties, specifically in 1931 (13,102 *fallimenti*). The number of *fallimenti* then began to decrease. It must be noted that during both World Wars years the number of *fallimenti* and the GDP's fluctuation decreased considerably. The number of *fallimenti* was at the minimum during World Wars, and particularly during World War II (420 in 1918 and 91 in 1944). This result is probably due to the stagnation of economic activity during wartime, and in particular to the general inefficiency and inactivity of the legal bodies in charge of the administration of bankruptcy and insolvency procedures. Thus, the substantial growth in the number of *fallimenti* in the post-wars years is partially explained by the re-staring of court proceedings that were not in effect in previous years.

It is worth noting that, despite the absence of a long-term negative correlation between the number of *fallimenti* and GDP growth, during specific sub-periods such a relation seems to emerge. In particular, between 1901 and 1911 the hypothesis that as the

GDP grows the number of *fallimenti* goes down seems to be confirmed. This regularity finishes in the years just before the First World War. In the early Sixties a similar, although less evident, regularity is also shown, when GDP growth goes along with the decrease of the number of *fallimenti*.

Fig. 2 and in tab. 1 show that *fallimento* is the most wide-spread procedure during the whole period, representing more than 90% of the total procedures, notwithstanding the introduction of alternative procedures in 1903 (the *concordato preventive) and 1942* (the *amministrazione controllata*).

Fig. 2. Percentage of *concordato preventivo* and *amministrazione controllata* on total procedures (1901-1980)



Sources: our own elaborations on Istat, *Annuario delle statistiche giudiziarie* [various years].

During the first years after its appearance on the scene, the *concordato preventivo* accounted for about 4% of total procedures, while in the following years its use decreased considerably. Even the introduction of *amministrazione controllata* in 1942 didn't alter this

situation. During the Forties and the Fifties, *fallimenti* accounted for about 98% of the total procedures, while the *concordato preventivo* and the *amministrazione controllata* made, together, only to the residual 2%. This seems to show that the new procedures were not able to fit the aims for which they have been introduced. Their use began to grow at the end of the Seventies when the two procedures together made about 10% of the total. The analysis of the data shows also that the *amministrazione controllata* wasn't able to substitute the *concordato preventivo*.

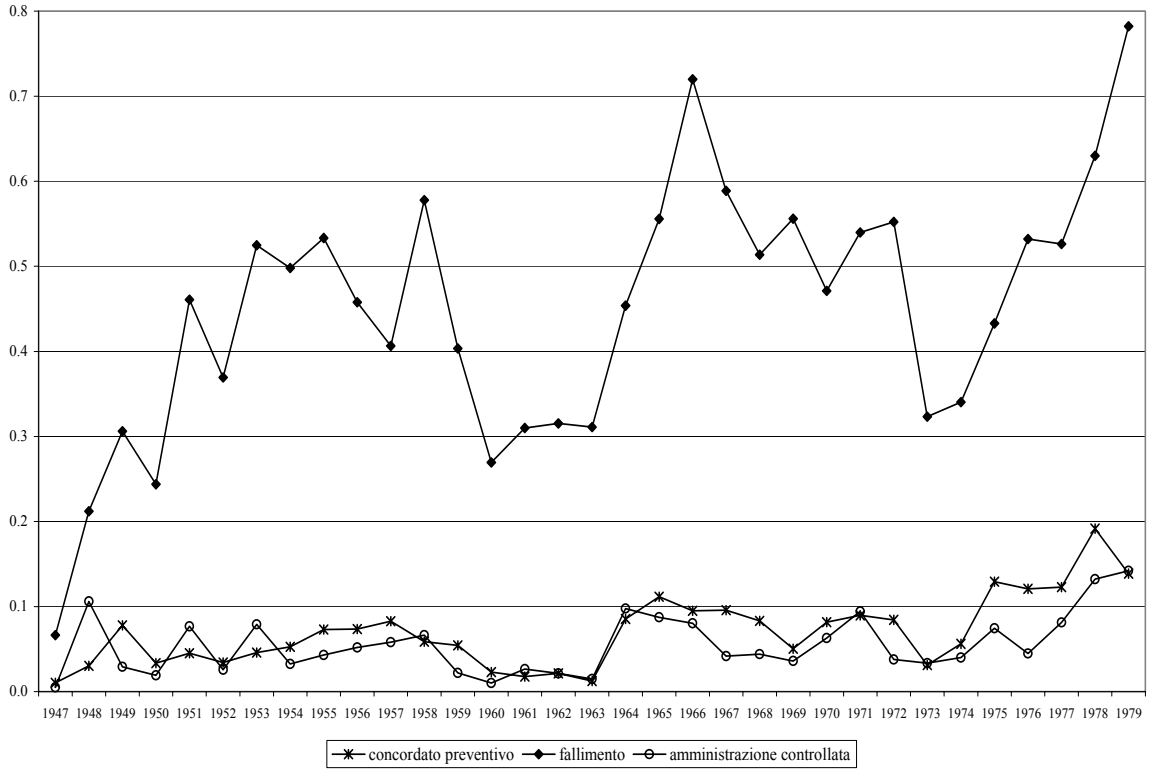
Tab. 1 Average number of *concordato preventivo*, *fallimento*, and *amministrazione controllata* in period of five years (1901-1980)

Period	*Concordato preventivo*	*Fallimento*	*Amministrazione controllata*
1901-1905	94	2,427	
1906-1910	65	2,209	
1911-1915	76	3,973	
1916-1920	6	672	
1921-1925	105	5,011	
1926-1930	245	10,701	
1931-1935	281	10,289	
1936-1940	42	3,555	
1941-1945	3	440	0
1946-1950	25	3,007	23
1951-1955	53	6,600	35
1956-1960	58	7,590	37
1961-1965	60	6,450	53
1966-1970	137	7,210	59
1971-1975	123	5,084	61
1976-1980	243	5,294	148
Total	102	5,126	61

Sources: our own elaborations on Istat, *Annuario delle statistiche giudiziarie* [various years].

Another important point that emerges from the analysis concerns the role of the joint-stock companies. As we can see in fig. 3, during the whole period, the percentage of joint stock companies that used one of the three procedures is very low, remaining below the threshold of 1% of the total population. In other words, only less that 1 in 100 companies in the country officially faced insolvency problems. As far as the different procedures are concerned, joint-stock companies mainly use *fallimento*, and the quota of businesses filing for *concordato preventivo* and *amministrazione controllata* accounted for 0.1% of the total population. These data show that for joint stock companies all procedures plaid a marginal role.

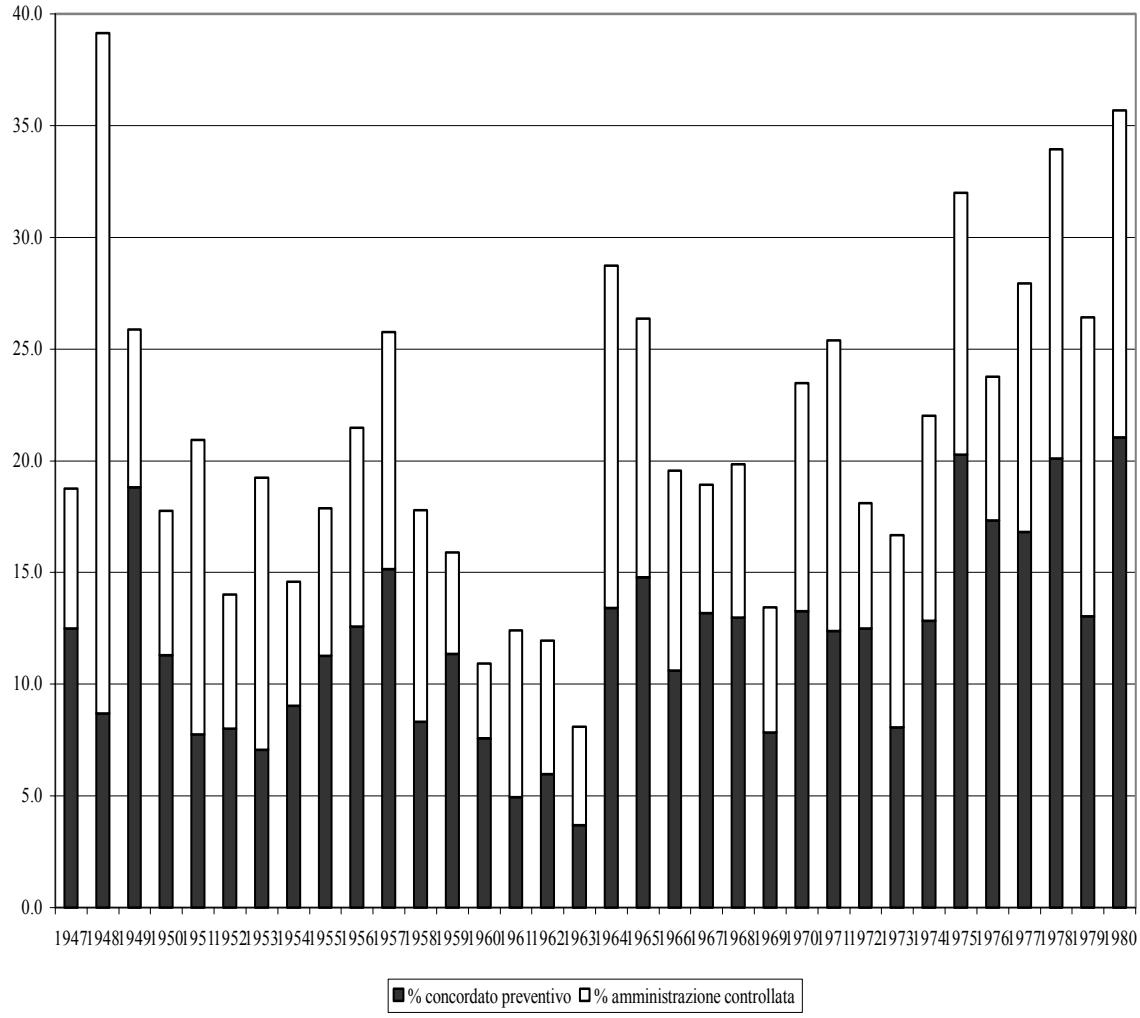
Fig. 3. Quota of joint-stock companies using various insolvency procedures on the total population of Italian joint stock companies (1947-1979)



Sources: our own elaborations on Istat, *Annuario delle statistiche giudiziarie* [various years].

Disaggregated data for different kinds of debtors are available only since 1947 (fig. 4). These data show that joint-stock companies made recourse to *concordato preventivo* and *amministrazione controllata* differently with respect to other kind of businesses (compare fig. 4 and fig. 2). Even if also for joint-stock companies the quota of *fallimenti* on total procedures still prevails (79% in average during the period), the percentages of *concordato preventivo* and *amministrazione controllata* are considerably higher (11.6% the former and the 9.3% the latter in average during the period) than in the sample including all kind of businesses. In the Seventies in particular, for joint-stock companies the quota of the sum of these two procedures seems to become stable around 20% of total procedures.

Fig. 4. Joint stock companies: percentage of *concordato preventivo* and *amministrazione controllata* on total procedures (1947-1980)

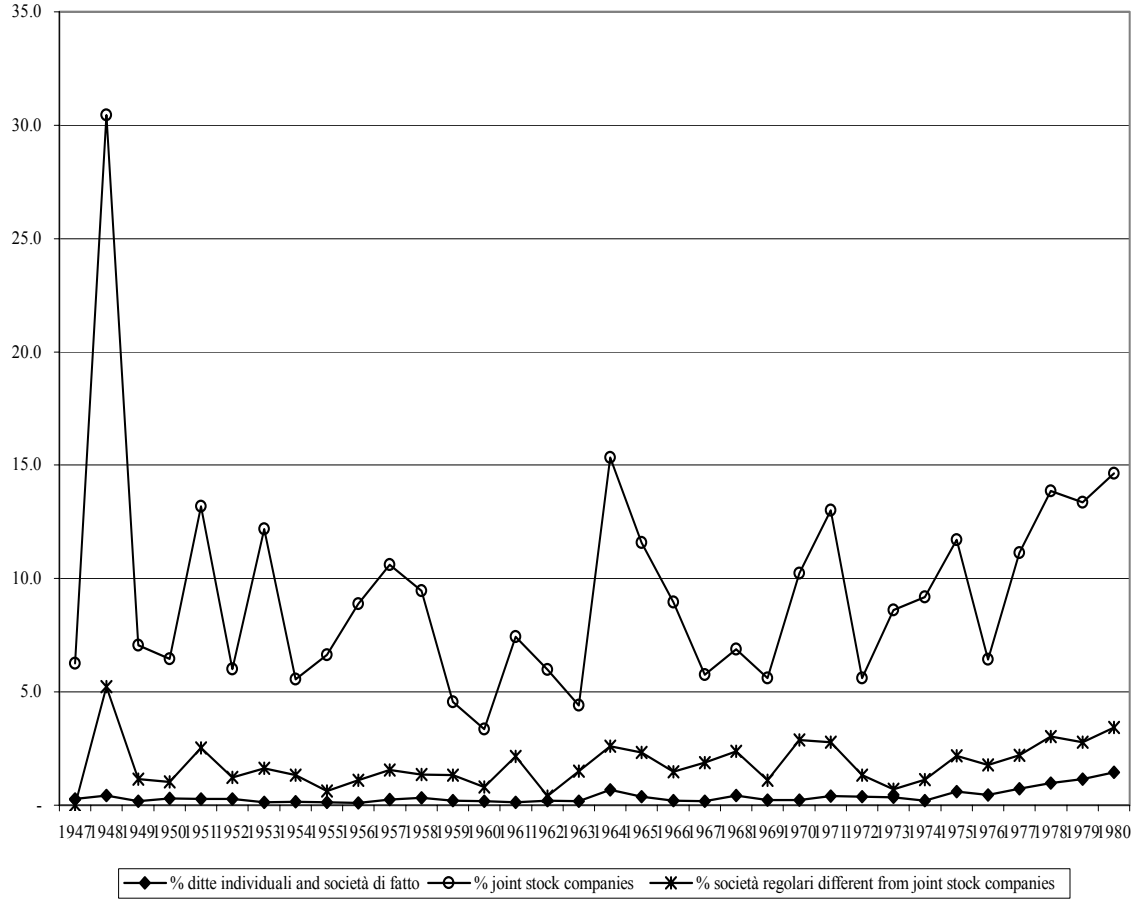


Sources: our own elaborations on Istat, *Annuario delle statistiche giudiziarie* [various years].

This suggests that the use of the *amministrazione controllata* as a tool to avoid *fallimento* and let the company continue in business varied widely among different types of companies (fig. 5). In particular, we can note a negligible use (0.4% on total on average) of these procedures for the *ditte individuali* (sole ownership) and *società di fatto* (partnership), particularly prone to use *fallimento* (98.7% on average). This was probably the natural solution to the problem of inheritance in case of death of the owner of the business. The use of this procedure is also marginal (1.8% on total on average) for the so-called *società*

regolari[16] (different from joint stock companies) that filed for *fallimento* in 95.2% on cases. To sum-up, joint stock companies had the wider usage of *amministrazione controllata* (9.4% on average) and lower use of *fallimento* (7.8% on average) than any other kind of businesses. This seems to indicate a different propensity of joint stock companies that, following the hypothesis of this paper, could be classified among the "good companies".

Fig. 5. Distribution (in percentage) of different kind of businesses using the *amministrazione controllata* (1947-1980)



Sources: our own elaborations on Istat, *Annuario delle statistiche giudiziarie* [various years].

Thus, generally speaking, the analysis shows that procedures alternative to *fallimento* were utilised in marginal way. On the one hand, it is worthwhile to note the

[16] *Societa' regolari* include a number of types of businesses which differs from joint-stock companies in terms of structure, organisation, and legal requirements. Among *Societa' regolari* the followings are included: *società in nome collettivo*, a *responsabilità limitata*, in *accomandita semplice e per azioni*, *cooperative*, *mutue assicuratrici*.

exception of joint-stock companies, a relevant percentage of which (20% on average) made recourse to these procedures. On the other hand, however, it is important to remind that in general the number of joint-stock companies (and therefore the percentage on the total population of joint-stock companies of the country) that used any kind of insolvency procedures was extremely low (the maximum, reached in 1979, was 1.1% of the total number of companies).

IV. Corporate insolvency in 1920s Milan

The quantitative analysis conducted in section III shows that *fallimento* was by far the most wide-spread procedure. Before the appearance of new procedures in 1942, *concordato preventivo* was the only alternative. As mentioned in section II, this was a milder instrument and was reserved to "honest but unlucky" debtors. It follows that, in theory, if procedures were well-conceived and implemented, recourse to *fallimento* and *concordato fallimentare* would be confined to companies whose failure was caused by incompetence and/or fraudulent behaviour and/or structural crisis. At the same time, companies whose problems were caused by short-term contingences or exogenous shock were supposed to have filed for and to have obtained *concordato*. The aim of this section is to analyse the extent to which empirical evidence support this hypothesis. This section is based on a sample of insolvent companies in Milan and its province between 1922 and 1928.[17] Out of 59 companies, we focus on 25 for which extensive information about the causes of failure and the instruments used to deal with it is available. Table 2 provides a summary of the causes of crisis and the outcomes. Causes are homogenised using the following categories: "fraud" (indicating any sort of unsound behaviour or disrespect of good practices), "incompetence" (when indication of mismanaging emerged), and "exogenous crisis" (when the crisis was due to external factors.

At first glance, the evidence provided in table 2 seems to show that, in fact, insolvency legislation had to deal with companies deserving little mercy. In 15 out of 19 cases about which reasons leading to insolvency are known, incompetence and/or some kind of fraudulent or irregular behaviour are indicated as the causes. It is therefore not surprising to discover that the vast majority of procedures consisted of *fallimenti* and *concordati fallimentari*.

[17] Archive of the Chamber of Commerce of Milan (ACCM), *fondo* "Imprese fallite e relazione dei curatori falimentari" (fI).We focus on the 1920s for the sake of consistency with the sample used in section V.

Table 2: summary of insolvent companies in Milan, 1922-1928 (Causes and outcomes of insolvency).

Company name	Year in which the procedure begin.	Causes	Outcome
Bacapa	1928	Unknown	Unconown
Cartiera Albano Franchini	1928	Unknown	Concordato Preventivo
Cimenti	1927	Fraud	Fallimento/Concordato fallimentare
Combustibili	1924	Exogenous crisis	Fallimento/Concordato fallimentare
Commercio calzature	1925	Fraud	Fallimento/Concordato fallimentare
Compagnia magazzini generali Alta Italia	1925	Fraud	Fallimento/Concordato fallimentare
Esportazione Importazione Italo Americana	1926	Fraud	Fallimento/Concordato fallimentare
Explorer	1928	Unknown	Fallimento/Concordato fallimentare
Fabbrica Utilità Speciali termoelettrici (FAUST)	1926	Structural crisis	Fallimento/Concordato fallimentare
Fabbrica Appretti e Affini	1923	Incompetence	Fallimento/Concordato fallimentare
Fabbrica Italiana Articoli Reclam	1924	Incompetence	Fallimento/Concordato fallimentare
Ferro Acciaio Stampato	1924	Unknown	Fallimento/Concordato fallimentare
Ferro Metalli Macchine	1928	Fraud	Fallimento/Concordato fallimentare
Florentia	1927	Incompetence	Fallimento/Concordato fallimentare
Italia Nuova	1925	Incompetence	Fallimento/Concordato fallimentare
Italiana Copricatene e Affini	1929	Incompetence	Fallimento/Concordato fallimentare
Italiana Giglio	1928	Exogenous crisis	Fallimento/Concordato fallimentare
Italiana Kanold	1928	Fraud and incompetence	Fallimento/Concordato fallimentare
Officine Italiane Costruzioni Elettriche	1925	Incompetence/Exogenous crisis	Concordato Preventivo
Officine Meccaniche Industria Ciclo	1925	Unknown	Fallimento/Concordato fallimentare
Radio “Del Vecchio”	1928	Unknown	Fallimento/Concordato fallimentare
Ristoranti Famigliari	1928	Incompetence	Fallimento/Concordato fallimentare
Sacmar	1925	Fraud	Fallimento/Concordato fallimentare
Tettamanzi	1928	Incompetence (fraud?)	Fallimento/Concordato fallimentare
Tulli	1928	Incompetence	Fallimento/Concordato fallimentare

Source: our own elabopration on Archive of the Chamber of Commerce of Milan, *fondo* “Imprese fallite e relazione dei curatori falimentari”.

This view, however, is neither exhaustive nor totally correct, as exceptions to the rule prove very revealing of the inefficiencies of the Italian system. First the two cases of *concordato preventivo* shed some lights on the difficulties linked to the absence of legal instruments conceived to avoid undue companies' liquidation and they will be analysed in the next section. Second, also among companies facing *fallimento* there are four cases that deserve further analysis. The first one is the company called *Explorer*. Little is known about the causes of this distress and the reasons leading to the *fallimento*. However, the remarkable thing is that at the end of the procedure the firm managed to pay all its debts, showing substantial financial stability and representing the typical case of a company deserving, at least, to avoid the harshness of *fallimento*.[18] The company called FAUST *(Fabbrica Utilità Speciali termoelettrici)* is the second interesting case. Despite the very strict conditions imposed by the Italian law to be allowed *concordato preventivo*, this company managed to fulfil the requirements. Also, the FAUST appeared to have been the victim of structural problems, but no fraud or visible incompetence surfaced. However, because of the action of one single creditor, the FAUST was denied this opportunity and condemned to *fallimento*.[19] This case shows that matching very tight requirements was a necessary, but not a sufficient condition to avoid *fallimento* via *concordato preventivo*. The company *Societa' Anonima Combustibili* is the third example.[20] In this case, we are in front of the typical case of a company insolvent because of short-term and largely exogenous problems, in particular the failure of the BIS.[21] This case signals how in the pre-1942 scenario, the absence of any form of procedure conceived to re-launch illiquid but structurally sound companies lead to the elimination of worthy concerns. Finally, the example of the *Societa' Anonima Italiana Giglio*[22] reveals the problem faced by an innovative but unlucky company. The *Italiana Giglio* was a pioneer in the production of speedometers. In the early 1920s the sector was not developed yet, but the *Italiana Giglio* foreseen a business opportunity, also on the expectation of a law to be passed to make these devices compulsory on police cars. Delays in the approval of the law, as well as general stagnation of demand, caused financial problems and led to insolvency. The fact that this forward-looking company faced a destiny similar to the one of fraudulent or remarkably

[18] ACCM/fI, "Societa' anonima Explorer"
[19] ACCM/fI, "Societa' anonima FAUST"
[20] ACCM/fI, "Societa' anonima Explorer".
[21] The crash of the BIS in 1921 was one of the most famous cases of financial crisis in Italy and a major shock to the Italian economy.
[22] ACCM/fI, "Societa' anonima Italiana Giglio"

incompetent businessman suggests that Italian law and procedures suffered from structural problems.

V. Corporate insolvency: the 1920s and 1950s compared

The picture painted in the section above reveals that insolvency procedure based on assets liquidation and distribution among creditors was not necessarily confined to unsound and/or fraudulent companies. A share of firms would have deserved better-suited instruments in order to have a further chance. In 1942 such instruments were eventually provided. It is therefore of interest to see whether or not remarkable differences in the approach to the problem of insolvency can be noticed between the pre and post 1942 period. In order to analyse this point we focus on companies which interrupted their activity in 1924 and in 1954.[23]

In theory firms that stop operating are not necessarily either illiquid or insolvent. In fact it can be the case that they simply face difficulties and, if no prospect of re-launch appears, they decide to put an anticipated end to their life before running into further trouble. In these circumstances companies go for voluntary liquidation. However, as stressed in section II, in England and the US voluntary wind-up was often the first step towards restructuring via specific legal procedures, also conceived to counterbalance the action of a minority of reluctant creditors. In Italy restructuring was allowed, but was not protected by specific legal devices.

Analysing the sample of companies put in liquidation in the 1920s and 1950s it appears that re-starting mechanisms allowed by the Italian law had subsantial limitations. First, even if restructuring was theoretically possible, the absence of instrument conceived to look-in creditors proved a serious problem. Out of the 18 cases recorded for 1924, 5 companies explicitly complained about the difficulty to raise new capital to re-launch the business.[24] In one of those cases another interesting problem surfaces. The *Società Elettrotecnica* was put into liquidation in 1924 and terminated the procedure in 1930. Since 1928 administrators foresaw the possibility of future new business and decided to temporarily suspend liquidation, keep current activity to a minimum, and to wait for the moment to present a restructuring plan. The pursuit of this strategy however had to be

[23] The sample includes all companies in the Milan province with net worth above a given threshold, the ones whose administrators' names are known. Unfortunately, more extensive information has been found only about a limited number of companies in the sample.

[24] Administrators of following companies noticed this problem in the annual official report of the year in which liquidation procedure started: F.A.R.E., *Officine Pesaro*, *Elettrometallurgica Sarda*, *Eletrotecnica Forniture Industriali*, and *Cucirini Italiani*. (source Bollettino Ufficiale delle Società per Azioni, 1924)

interrupted because the company found it impossible to find an agreement to procrastinate the payment of already-due taxes. In practice it was the state that, operating as an ordinary creditors, created an insurmountable obstacle to attempt the company's re-launch. Other interesting examples of difficulties that sound companies faced in the attempt to avoid liquidation can be found in the sample used in section IV. As mentioned above, in two cases the *Cartiera Albano Franchini*[25] and the *Officine Italiane Costruzioni Elettriche (OICE) concordato preventivo* was allowed. In both cases preliminary agreement with creditors to avoid liquidation was tried but the attempt failed. While in the former case we do not know exactly why the agreement was not accepted, the latter example is interesting enough to deserve a more detailed analysis. Since 1917 OICE had been operating in the very dynamic sector of electric engineering. The company faced a number of structural problems between 1917 and 1924 because of the war first and of the general depression which followed the BIS crisis after. On top of these problems, managerial incompetence and the excessive ambition resulted in financial unbalance. However, the company still had a huge potential to develop in a fast-growing sector, as proved by its balance sheets. In front of liabilities of about 1.3 million lira, most of which financial exposure, the company had assets worth about 1 million, most of which consisting of plans, materials, and up-to-date machinery. In other words, it was the typical case of a company worth an inflow of fresh capital and to restart under different management. Despite these favourable conditions, no agreement was reached and the company ended-up liquidated, although under the "friendly" procedure of *concordato.*[26]

All this evidence, although patchy, suggests that companies' restructuring was not an easy business under the Italian legal regime. In such a framework it is reasonable to assume that firms running temporary problems would not find the option very tempting. Given the harshness and inefficiency of insolvency procedures, companies would find even less tempting the option of continuing their activity trying to solve short-term difficulties running the risk, in case of luck of success, of dealing with *concordato preventivo* and *fallimento*. These problems combined together could have generated the tendency to rush into liquidation even in cases in which companies were in the position of trying to defend their business or restructuring and start again. This hypothesis is in line the evidence, provided in section III, of an extremely low number of joint-stock companies using

[25] ACCM/fI*, Societa' anonima Cartiera Albano Franchini*.
[26] ACCM/fI*, Societa' anonima Officine Italiane Costruzioni Elettriche.*

insolvency procedures. Although not in a systematic way, primary evidence gives some support to this hypothesis. First, in 2 out of 8 cases about which complete information is available, liquidation ended up distributing a relatively high share of the net worth. In the 1920s, the company *La Petrolifera* at the end of the procedure was able to recover about 2/3 of net worth.[27] Interestingly, this problem was not limited to the 1920s, but surfaced also in the 1950s after the introduction of *amministrazione controllata*. The case of the company *ZAMAR* is particularly interesting, as at the end of liquidation stockholders received more than 60% of the value of their shares.[28] The case of the company *Industrie Meccaniche Servadei Benetti* is even more revealing. The company started the liquidation procedure in 1924. In 1942 however, administrators realised the impossibility of convenient assets liquidation and the "inopportunity" of closing down the company. It was only at this stage that a plan of re-financing and re-launch of the firm was suggested. It is interesting to notice that this last resort strategy proved successful as creditors agreed to put new capital in the business.[29] In other words, a restructuring plan, which eventually succeed, was tried only after a long phase in which only liquidation was (unsuccessfully) attempted.

VI. Concluding remarks

Companies' insolvency is a permanent feature of capitalistic economies, both in periods of stability and during phases of technological and organizational change. Insolvency might be the sign of incompetence and fraudulent behaviour, as well as the consequence of domino effect, exogenous shocks and macro instability. In order for an economic system to deal efficiently with these problems, insolvency and bankruptcy laws and procedures must be able to select among worthy and unworthy companies and, while severely punishing the latter, give a second chance to the former.

Despite its relevance, and the general flourishing of studies on Italian industrial history, this subject received little attention in the Italian literature. This paper represents a still provisional attempt to fill this gap analysing the way in which the Italian legal system dealt with problems of companies' insolvency and instability. Contrary to what happened in Anglo-Saxon countries, before 1942 the Italian law did not contemplate any instrument conceived to avoid undue liquidation of insolvent companies. The system was organised

[27] ACCM, *Anagrafe Ditte* (ACCM/AD), Società *La Petrolifera.*
[28] ACCM/AD, Società *Zamar*.
[29] ACCM/AD, Società *Industrie Meccaniche Servadei Benetti.*

around two major procedures: *fallimento* (with the variant of *concordato fallimentare*) and *concordato preventivo*. The former was simply a form of assets liquidation and distribution among creditors, while the latter was a form of agreement between debtors and creditors which in theory contemplated the option of re-starting businesses but, in fact, tended to lead to liquidation. After 1942 the *amministrazione controllata* was provided as a device to avoid liquidation and to give sound companies the possibility to overtake lack of liquidity problems. Along the whole period, the Italian legislation was also deficient in terms of providing instruments to turn voluntary wind-up into companies restructuring.

This paper shows that the Italian legislation was inadequate before 1942 and that the situation did not remarkably change after. Quantitative evidence shows that over the whole period *fallimento* remained the by far the most wide-spread solution to insolvency, and that only joint-stock companies managed to exploit the opportunity of using *amministrazione controllata* in a relatively more extensive way. This results confirm the limits of both *concordato* and *amministrazione controllata*. Qualitative evidence integrates this results suggesting that *fallimento* was used also to deal with companies whose insolvency was caused by short-term problems and/or whose conditions would have justified the attempt to avoid liquidation. Quantitative evidence also shows that, in total, official procedures of all kind were very low in number, especially concerning joint-stock companies. This result is supported by qualitative sources evidencing how companies probably tended to over-use the instrument of voluntary wind-up. However, while in other countries voluntary wind-up was conceived as a step towards companies' restart, in Italy this option was limited by the absence of instruments to look-in reluctant creditors. As a consequence friendly agreements were rarely attempted and implemented.

This paper represents a starting-point rather than a final conclusion. More extensive research is necessary to confirm the validity of these provisional results, as well as to analyse in detail the reasons why the Italian legislation was so poor, why it did not change, and, more importantly, which kind of consequences institutional inefficiency had in terms of industrial stability, entrepreneurship, and innovation.

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