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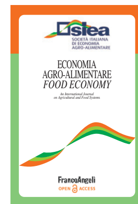

Changes in SMEs financing: Risks and opportunities for agro-food companies

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Abstract

The financial and real crisis started in 2007-2008 has deeply transformed the way the Italian financial and capital market act. Italian SMEs need to be aware of the transformation not to be pushed out of the market itself and to take profit of the new relevant opportunities coming out thanks to the emerging new products and new intermediaries.
The paper focuses the disappear of banks relationship lending and provides evidence about how to approach the market in the emerging "competing for capital" prevailing rule.
It also stresses the relevance of ESG topics as emerging risk factor companies must look at when asking for new finance because of the Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability related disclosures in the financial services (SFDR).

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Introduction

The international financial crisis, which arose with the default of sub-prime mortgages, led to the failure of several major international credit institutions, starting with the British Northern Rock in 2007 and then culminating with the US Lehman Brothers in 2008.

The resulting contagion effect produced heavy repercussions worldwide not only in the banking and financial sector, but also in the real world, with the huge decline in world trade and widespread recessionary conditions.

To face the situation, the central banks, on the one hand, combined maneuvers aimed at rescuing banks in difficulty together with a more careful and precautionary regulation of the banking and financial sector[1] and, on the other hand, activated expansionary measures for the economy as a whole.

The result was operational mechanisms for the allocation of credit by the banking system profoundly different from those to which a historically bank-centric system such as the Italian one continued to operate even in partial defiance of the precepts already introduced by the Basel Accords and their periodic revisions. In fact, the approach based on pure relationship lending and on the diversification of risk on a statistical basis, that is on the provision of relatively small loans to a large number of customers, definitively disappeared. Instead, an eminently market approach took place, based on the analysis of customer fundamentals in line with the key dictate of finance given by the risk-return combination in a forward looking approach.

These are rules of the game that in many cases Italian companies were not prepared for and it is essential to get familiar with in order to seize the interesting opportunities that may arise and stop to regret a past that will inevitably never return.

1. Towards the competition for capital

In a full free market context, the financial and capital market selects the investment opportunities where to allocate the mass of available savings and plays this role by maximizing the growth rate of the economy.

Under the hypothesis of perfect and complete financial markets, introduced by the financial economists of the so called modern theory of finance, the

1. Stress test activities were implemented to measure the vulnerability of institutions and greater attention was paid to quantifying the regulatory capital required for the loans activated, with increases due to the Supervisory Review and Evaluation Process (SREP), to the adoption of the IFRS 9 accounting principle and, more recently, with the Calendar Provisioning adoption, which imposes greater prudential provisions for non-performing loans.

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market itself provides optimal allocation and investors just have to diversify their portfolio in order to mitigate overall portfolio's risk and achieve optimal risk-return combination (Markowitz, 1956). Within the market portfolio, asset specific risk will be diversified away to the extent possible, so the relevant measure of the risk of a security is the risk it adds to the market portfolio, and not its risk in isolation. In this context, the volatility of the asset, and its correlation with the market portfolio, are historically observed and investors just have to combine the market portfolio of risky assets with the risk-free investment in order to have the top return for the targeted level of risk (Sharpe, 1964). It follows that companies can be considered black boxes and their capital structure is irrelevant (Modigliani and Miller, 1958). Subsequent studies proved that the model works even with not perfect markets, if at least efficient (Fama, 1970), and a market is efficient if prices immediately and fully reacts to upcoming information. The empirical evidence supporting the modern theory of finance mainly focused on listed public companies, highly traded in the stock markets.

Following studies showed that: market imperfections exist due to asymmetric risk sharing between shareholders and bond holders and between minority and majority shareholders too (Jensen and Meckling, 1976); different financing instruments can provide investors better risk diversification (Allen and Gale, 1994); "*most companies do have a large shareholder, who is not well diversified*" (Zingales, 2000, p. 1628). Therefore, capital structure does matter and investors should better pay attention to investment selection rather than just diversify the portfolio.

More recently, the relevance of investment selection has further grown because of the speed of technical innovation and its disruptive impact on competitive advantage of companies. Turnarounds must be frequently played together with the revision of the business models, so a resilient management approach is needed to mitigate company risk profile.

It follows that the selection of financial investments is based on two fundamental drivers: expected return and total risk. Looking at return means quantifying the ability of the invested money to find return over time; looking at risk means estimating the probability that the actual return differs, for better or worse, from the expected one.

Hence some first important considerations for companies (Bertinetti, 2021):

a) there is competition for capital, so it is necessary to be attractive to the market in terms of return-risk combination in order to attract the financial resources available on the market itself before they are directed towards alternative uses (i.e. other companies). This need is all the more stringent the fewer the overall available resources are compared to the opportunities outstanding in the market. The number of alternative opportunities is

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enormous as long as there are no geographical constraints since money is free to move very quickly from one part of the globe to the other;

b) the transfer of resources from the market to the company takes place in the face of "promises" of return, contractually regulated or not, given that the use of these resources made by the company inevitably takes time before generating return capacity, i.e. free operating cash flows (FCFOs);
c) the market needs to appreciate both the time it takes for the promised return to actually become available, i.e. adequate FCFOs begin to accrue, and the credibility of these promises;
d) the credibility of the promises depends on the risk profile of the business practiced and the goodness of the corporate strategy adopted, but also on the ability of the company to interface with the market, so as to enable potential investors to appreciate business risk and the company's ability to cope with it (Greenwald & Stiglitz, 1990). In the absence of this capacity it is easy for the market to perceive the presence of an additional risk component, defined in the Doctrine as "information risk" (Campbell & Kracaw, 1970). The attractiveness of the specific investment opportunity for a given promised remuneration would be reduced.

Basically, in this context, the ability of a company to find the financial resources necessary to carry out its business and to implement the chosen strategy depends, first of all, on its ability to identify investment opportunities that generate FCFOs big enough to let the company promise the market an adequate return, i.e. not lower than that of the alternative investment opportunities present on the market itself at the same risk. The company thus becomes an important piece of the virtuous growth circuit that the market aims to feed.

However, there is a second no less important aspect to consider: the risk appetite of existing investors on the market. In fact, not all risks are attractive to all investors, regardless of the return they can promise with adequate credibility. There are "patient" investors, who are willing to wait even medium-long times before receiving the return and there are "impatient" investors, who wish to almost immediately receive a return; the preference is not the result of purely subjective conditions, but mainly depends on treasury constraints and liquidity requirements to be respected. At the same time, there are investors who are very risk averse and others who are willing to take on considerable risks, in search of higher return; also in this case the preference does not depend on purely subjective assessments, but is mainly affected by the level of risk tolerance based on the investor's equity capital consistence and any restrictions imposed on it by the legislation. Adequate knowledge of the company ability to generate FCFOs in the future and also of the risk profile related to them therefore become essential for identifying and intercepting suitable market counterparties.

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2. Transforming change into opportunity

By combining the events described in the Introduction with the logic of competing for capital outlined in Paragraph 1, the decrease in overall loans disbursed by the Italian banking system to domestic companies, which fell by 27 billion euros between November 2011 and December 2017, is explained, as well as the concentration of bank lending in larger companies belonging to the best risk classes. The losses suffered by the banking system as a result of the insolvency of debtors pushed by the economic crisis eroded the regulatory capital of the institutions which, consequently, saw a decrease in the total amount of loans disbursable to the private sector because of the constraints introduced by the Basel agreements. Furthermore, the persistence of economic uncertainties, and the correlated fear of a further deterioration in the solvency of the companies that can be financed or are already financed, were further elements of caution which led to the concentration of bank loans to customers with a lower risk profile. Taking the 2002 situation as 100 basis, the average Risk Weighted Assets of Italian banks (RWA)[2] dropped to about 65 in 2021 (see: Bank of Italy, 2022, p. 169).

On the other hand, in the face of the evident credit rationing adopted by the banking sector, new interesting products have appeared on the market and categories of operators that were previously absolutely marginal have largely developed also in Italy. The three most important cases outlined below concern respectively:
a) Private Equity;
b) Minibonds;
c) Crowdfunding.

In the last decade there has been a growing presence also in Italy of private equity players, i.e. institutional investors who typically invest in the equity capital of unlisted companies, usually through the activation of closed-end investment funds. These closed- end investment funds are often focused on specific purposes, or business sectors, or even geographical areas. Many national and international funds focus on food, beverage and agro-business[3].

In the 10 years between 2012 and 2021 the private equity deals concluded in Italy have almost tripled (+ 280%) with total assets in the hands of Italian players which increased in the same period from 3 to 17 billion euros. Also

2. Risk-weighted assets (RWA) are used to determine the minimum amount of capital a bank must hold in relation to the risk profile of its lending activities and other assets. This is done to reduce the risk of insolvency and protect depositors. The capital requirement is based on a risk assessment for each type of bank asset. The more risk a bank has, the more capital it needs on hand.

3. Italian examples of such funds are Taste of Italy 2 and ADeAgro.

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the presence in Italy of foreign players has grown with investments which rose from 1.3 billion in 2012 to 11.1 billion in 2021 (Source AIFI).

It is important to note that this segment of the capital market is increasingly global with very important cross-border and even transcontinental investment flows (Table 1), which our country is able to intercept to a less than proportional extent with respect to its economic importance.

Table 1 - Private Equity: Geographical investment flows 2021

	€ bn
Non-EU investments in EU	8.9
EU investments outside EU	11.4
Cross-border investments within EU	45.7
Domestic investments in EU countries	83.2

Source: Our processing of data Invest Europe/EDC.

Developing the ability of Italian companies to enter the private equity circuit is therefore important to open a channel for the collection of "patient" resources willing to bear even significant risks, functional to the implementation of challenging development strategies and plans.

Alajmo S.p.A. and Rigoni di Asiago S.r.l. are examples of successful Private Equity investments in the Italian agro-food industry.

Thanks to Palladio Finanziaria, Alajmo S.r.l., a top quality catering company, revenues increased from 5 to 15 million euros between 2010 and 2017 not only opening new restaurants in Italy, but also expanding outside national borders. The private equity not only provided financial contribution, but also useful skills and networks contacts. At the end of the investment period the Alajmo family bought back all the shares.

Rigoni di Asiago S.r.l., a food company, got the support of Fondo Italiano di Investimento from 2011 to 2018. The private equity invested 14 million euros, of which 10 million euros of equity capital and 4 million euros of convertible bonds. The objective was the consolidation of the competitive position, the expansion and growth in national and international markets, and the expansion of the production capacity, also aimed at launching new products and innovative packaging. Rigoni di Asiago S.r.l. revenues increased from 56 to 113 million euros between 2012 and 2018, while the net profit jumped from 0,7 to 6,2 million euros. In 2018 Fondo Italiano d'Investimento sold its 35.55% participation in the company equity capital to the Swiss fund Khalis Partners, percentage subsequently increased to 42.70% by acquiring

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some shares from the Rigoni family that still owns the majority. Total revenues in 2021 was 118 million euros and the net profit 5,3 million euros.

Minibonds were born in 2012 thanks to Legislative Decree 83/2012 ‘Development’ and Legislative Decree 179/2012 ‘Development-bis’, when:

- have been eliminated the maximum quantitative limits to the issue of bonds previously established by art. 2412 of the Civil Code;
- the deductibility of interest expense has been extended to unlisted companies, for securities listed on multilateral trading systems and subscribed by qualified investors who do not hold more than 2% of the share capital;
- the deductibility of issue costs for unlisted companies has been envisaged;
- the exemption from withholding tax on proceeds for securities listed on multilateral trading systems of EU member states or “White List” countries was ordered.

Minibonds can be subscribed only by professional investors, but a deregulation in this regard is imminent, they can have a single final maturity (so-called *bullet*) or provide for periodic repayment (so-called *amortizing*). Their average duration settled at around 5.5 years.

An important capital raising channel was thus opened. In ten years it saw the completion of 1250 issues with a unit amount of less than € 50 million (Table 2), for a total collection of € 8.07 billion, of which € 2.85 billions by issuers belonging to the SMEs as defined by the EU (Figure 1). It is therefore an important opportunity to gather the resources necessary to support growth paths.

Table 2 - Monthly and cumulated issuance of Minibond

Year	Yearly number of issues	Total number of issues
2013	30	30
2014	71	101
2015	86	187
2016	110	297
2017	170	467
2018	166	633
2019	207	840
2020	191	1031
2021	219	1250

Source: Our pocessing of data: Rigoni U., Veller A., *Conference: Minibond – Quali evidenze per le imprese del Nord-Est a cinque anni dalla loro introduzione*, Auditorium M9, 8 maggio 2019 and Osservatorio Entrepreneurship Finance & Innovation, 8° *Report italiano sui Minibond*, Politecnico di Milano, different editions.

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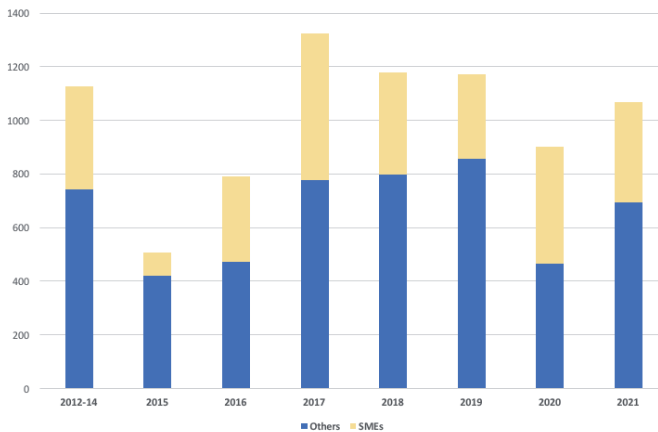
Fig. 1 - Capital raised and dimension of the issuers



Source: Our pocessing of data Osservatorio Entrepreneurship Finance & Innovation, 8° Report italiano *sui Minibond*, Politecnico di Milano, marzo 2022.

Many well known agro-food companies issued Minibond from the very beginning of their inception, like: F.lli De Cecco di Filippo S.p.A. (pasta producer); Nosio S.p.A. (winery); Rigoni di Asiago (food producer); Menz& Gasser (food producer); Pasta Zara (pasta producer)[4].

The aggregative forms called Basket Bond deserve particular mention within the Minibond category. These are coordinated issuance by several companies, even small ones, which are merged through a securitization process so as to reach a critical mass able to make them attractive for large institutional investors. Baskets are often focused on specific purposes, or business sectors, or even geographical areas. There is a frequent possibility of enjoying ancillary guarantees provided by third parties, such as SACE or the promoter Region, which contributes not only to the ease of placing the bonds, but also to reduce the interest rate to be promised to the market. Table 3 shows the list and the main characteristics of the Basket Bonds issued up to the end of 2021; the presence of an operation dedicated to the wine sector should be noted.

Thanks to the Garanzia Campania Bond program 10 agro-food SMEs have issued Minibond for a total of 20 million (15% of the total issued by the program). This way an important funding channel has opened up for local smaller companies with promising growth plans, like: La Contadine S.r.l.; Salerno Pesce S.r.l.; Davia S.p.A.; Qualitiagro S.r.l.; Bioitalia S.r.l.; Trade Coffee S.r.l.; Viniexport S.r.l.

4. Some company made more than one issue. For example, Rigoni di Asiago S.r.l. issued 7million euros Minibond in 2015 and 25 million euros Minibond in 2016.

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Table 3 - Basket Bond issued in Italy until 2021

Issue	Focus	Main investors	Nuber of issuers	Total amuont (€ mln)
Viveracqua Hydrobond (4 issues)	Integrated water system in the Veneto region	BEI, CDO, Kommunalcredit Austria	13	623.5
Garanzia Campania Bond	SMEs in Campania region	CDP, MCC	65	144.1
Basket Bond Puglia	SMEs in Puglia region	CDP, MCC, Unicredit	21	87.2
Export Basket Bond Programme	Companies belonging to the Elite programme	CDP, MCC	11	623.5
ELITE Basket Bond	Companies belonging to the Elite programme	BEI, CDP	10	122
ELITE - Intesa Sanpaolo Basket Bond	SMEs	Intesa Sanpaolo	18	135
ELITE Basket Bond Lombadia	Companies from Lombardia region belonging to the Elite programme	CDP, Finlombarda	4	37
Industry Basket Bond	Wine industry	CDP, Unicredit	3	21
Industry Basket Bond	Culture industry	CDP, Unicredit	3	21
Basket Bond Sella	Growth company	CDP, MCC, Banca Sella	2	24.5
Basket Bond Euronext Growth	Growth company listed on the Euronext	CDP, MCC, Banca Finnat	3	13

Source: Our translation form Osservatorio Entrepreneurship Finance & Innovation, 8° Report italiano *sui Minibond*, Politecnico di Milano, marzo 2022, p. 27.

Crowdfunding is a form of bottom-up microfinance that aims to mobilize a large number of people, each of whom contributes a modest sum to the realization of a project with either non-profit or for-profit purposes. Originally born to support "*donation*" and "*reward*" initiatives, in more recent years it has seen the growth mainly of "*lending*" and, above all, "*equity financing*" transactions, becoming today one of the most widespread and effective forms of financing new business projects of relatively small amount, as a maximum amount of € 5 million per transaction has been established by law.

The promotion of projects and the collection of financial resources takes place through digital platforms and has allowed to complete in Italy a number of *equity* financing campaigns always higher than 100 in each of the last 5 years, with a peak of 170 in 2021, for an overall capital collected which in 2021 exceeded 90 million euros (Table 4).

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Table 4 - Equity crowdfunding: capital raised and number of companies financed

Year	Number of companies	Capital raised (€/000)
2014	4	902
2015	7	1.714
2016	18	4.190
2017	47	10.597
2018	103	26.644
2019	119	45.406
2020	122	47.118
2021	170	90.352

Source: Our processing of data Crowdfundingbuzz.it.

Crowdfunding market is therefore still small in size and works in support of small projects. In most cases, the funded projects concern start-ups, but the share of resources raised by existing SMEs has grown in the last two years, reaching approximately 45% of the total.

The collection of *lending* crowdfunding is substantial, which for the part dedicated to the non-real estate business has led to total loans that have exceeded 270 million in the last year.

It should be noted that the three evolutionary trends outlined above also tend to overlap each other with projects that use several contemporary collection methods. Furthermore, since last year some platforms have also been authorized to sell Minibonds, a sign of a regulatory evolution taking place worldwide destined to bring growing masses of savers closer to investments in unlisted assets. The establishment of the European Long Term Investment Funds (ELTIF), launched by EU Regulation 760 and implemented in Italy with the Legislative Decree 233/2017, goes precisely in this direction.

The last of the three Minibond issued by Davia S.p.A., a tomato processing company located in Gragnano (Naples), was recently offered in the Fundera crowdfunding platform and in a few days the 1 million euros issue has sold out.

3. What challenges for the agro-food sector?

The solutions illustrated in Paragraph 2, which by the way do not exhaust the range of innovations that are affecting corporate finance in Italy, testify to the existence of important alternatives for the procurement of financial resources, such as to be able to make up for bank credit rationing.

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It is therefore important that the agro-food sector manages to enter the "new" finance circuit, learning to seize the opportunities that derive from it. This requires, in the first instance, to think about the two fundamental parameters already mentioned: return and risk.

Return is undoubtedly a problematic factor for the industry. The analysis of the economic performance of 61.762 Italian SMEs ranks the agro-food sector as one of only two critical sectors in 2017 in terms of return on capital (Banca IFIS Impresa, 2019). Entering the market finance circuit therefore requires an effort aimed at recovering efficiency if not even strategic innovation.

An important contribution in this direction can come from a deep effort of digital transformation (Finotto and Mauracher, 2020) and orientation towards eco-sustainability (Mauracher, Procidano and Valentini, 2019).

Digitization paves the way for smart agriculture and the internet of farming, which are a prelude to the optimization of production processes and the best possible satisfaction of customer needs, even thanks to more precise paths of traceability and certification of origin.

Environmental sustainability is now the object of consumer attention and the propensity to buy organic products with a low environmental impact is growing and will grow significantly in the near future, especially in the groups of consumers with the highest level of education and income (CSRI, 2022) and, therefore, with greater spending power and less attentive to the price factor. Mass organic, circular economy, hydroponic crops, vertical farming are important ideas for starting the process of strategic innovation and recovering the ability to pay a return on capital. There are many studies and empirical tests that testify, among other things:

- high customer loyalty for companies more sensitive to sustainability issues (De Luca, Lucido, 2022);
- the availability of growing numbers of end users willing to pay higher prices for "sustainable" products (EY, 2121 and EY, 2022).

The issue of sustainability is equally relevant with regard to the risk parameter. If final consumers become more sensitive to the issue, the entire supply chain is called upon to oversee this aspect, since distributors will ask producers to certify the quality of the products and these, in turn, will impose the same attention on their subcontractors, whatever their position along the value chain and also their size. Failure to adapt promptly exposes to the risk of being placed on the edge of the market and, over time, even being expelled. Also in this case there are many studies and empirical tests that testify, among other things:

- the higher market value of ESG compliant companies (Atz *et al.*, 2021);
- the lower volatility of the share prices of companies with the best ESG rating even in contexts of disrupted economy (Giakoumelou *et al.*, 2022).

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Further strengthening the opportunity to promptly turn towards eco-sustainable strategies is the fact that both the regulatory-political-regulatory system and the financial and capital market are pushing in the same direction.

With regard to the legislative-political-regulatory system, think of the attention that in Italy is dedicated by the National Recovery and Resilience Plan (NRRP)[5] to the modernization of the agro-food sector, for which 4.9 billion euros have been allocated[6], beyond the many legal provisions already adopted and the shared commitment at international level on environmental protection.

However, the opportunity to find financial resources by launching a strategic innovation project aimed at sustainability is not only linked to the economic moment that led to the aforementioned public aid, but is on the way to become structurally functional for access to the entire capital and financial market. In fact, on 10 March 2021 the Sustainable Finance Disclosure Regulation (SFDR) provided for by EU Regulation 2017/2088 and EU Regulation 2020/852 came into force throughout Europe, through which it is clear the intention to make the capital and financial market a decisive push factor of the entrepreneurial system towards the ecological transition.

Indeed, the SFDR does not simply aim to ensure that all players in the world of finance provide clear, transparent and standardized information to investors in relation to ESG products and policies, but rather looks to the creation of a common European framework for the promotion of sustainable investments. The financial industry, starting with the banking system, is thus required to:

- integrate sustainability risks into decision-making processes for the selection of loans and capital investments;
- consider the ESG factors among the relevant parameters for determining the variable component of personnel remuneration;
- report, in the annual report, on the activity actually carried out in support of sustainable initiatives.

In this direction, the SFDR expressly envisages the development of:

- financial instruments that "promote environmental or social characteristics, or a combination of these characteristics" (art. 8);

5. The National Recovery and Resilience Plan is part of the Next Generation EU (NGEU) program that the European Union negotiated in response to the pandemic crisis. The Italian NRRP envisages investments and a consistent reform package for the total amount of € 222.1 billion. The Plan is developed around three strategic axes shared at a European level: digitalisation and innovation, ecological transition, and social inclusion. The intervention that not only aims at repairing the economic and social damage caused by the pandemic crisis, but also at addressing the structural weaknesses of the Italian economy, andleading the country along a path of ecological and environmental transition.

6. The amount also includes the resources of the Complementary Fund allocated by the Government and those of the React-Eu programme of the European Commission.

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- financial products that target sustainable investments (with or without a benchmark) or those that aim to reduce carbon emissions. (art. 9).

Several concrete experiences have already been gained in this regard with the appearance of sustainability-linked bonds and loans, which also allow significant savings in the cost of debt upon achieving the agreed sustainability goals by the financed company. It is easy to foresee that further stimuli in this direction will come in the near future, when the ESG parameters will determine a reduction coefficient of the above mentioned Risk Weighted Assets (RWA).

The specific characteristics of the agro-food sector, highly exposed to ESG risks, mean that the outlined evolutionary trend of the capital and financial market is on the way to open up significant opportunities for easier access to capital and loans. On the contrary, failing to promptly give attention to and report on the sustainability of company activities, processes and projects exposes to the risk of being placed on the sidelines also of the capital and financial market and, over time, even being expelled from the market itself.

Conclusions

A new era has begun in Italy for corporate finance, closely aligned with the evolution of corporate finance models and attitudes and therefore aimed at supporting value creation strategies. That is the way to promise and provide adequate return over time to the risks which inevitably exposes those who contribute, with either debt or equity, the financial resources needed to implement the strategy itself.

Entering the circuit of such a market with satisfaction requires some preliminary cautions which can be summarized as follows:

- develop a clear orientation towards the future, making projects developed in a medium-long term strategic plan;
- quantify the financial resources needed to implement the plan;
- carry out scenario analysis in order to perceive the risk profile of the plan, a risk which, consequently, the players of the capital and financial market are asked to share.

These are the essential starting points to be able to select products and categories of intermediaries consistent with the proposed return-risk profile and, equally important, to prepare an adequate and credible presentation of the profile itself.

In this regard, it is also useful to highlight the way the company plans to act to mitigate the risk profile and make it economically and financially sustainable, which means minimizing the probabilities of insolvency and default consequent to the various scenarios that can be foreseen. In this

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context, ESG risks are assuming great importance and cannot be forgotten, both in their material dimension and in that linked to the ecological transition.

Even unforeseeable scenarios, linked to any extraordinary events, should be considered by preparing recovery plans that can be activated if necessary.

A good and complete presentation should testify to full knowledge and mastery of business risks and, with them, provide clear evidence of the managerial skills on which the company can rely. This is the qualitative aspect necessary to avoid the emergence of a perceived "information risk" that often stems from a lack of dialogue and understanding between the company and the capital and financial market.

Overall, by adopting these measures and effectively communicating with the market, companies can navigate the Italian corporate finance landscape and seize opportunities for growth and value creation.

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