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Private Debt and Alternative Financing: Minibond and FinTech initiatives to support SMEs and lead them out of the Credit Crunch of 2020

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SUMMARY IN ITALIAN

Il presente elaborato propone un'analisi della realtà attuale, permeata dall'emergenza Covid-19 e affronta diverse tematiche di difficoltà sorte nel mondo economico-finanziario mantenendo una struttura ad imbuto. Nel primo capitolo sono illustrate le attuali contingenze macroeconomiche e i rispettivi interventi centralizzati mirati a mitigare l'impatto negativo di questa ondata di pandemia. Dati presi dall'IMF e da altri istituti statistici ci permetto di quantificare i danni e di costruire una base causale per gli argomenti affrontati in seguito. Sempre in questa prima parte viene introdotta la figura delle PMI, come aziende di piccole e medie dimensioni, da sempre linfa vitale di tutti i sistemi economici nel mondo, il nostro tra i primi. Un interessante spunto di riflessione viene proposto in chiusura del primo capitolo, portando il titolo "L'Esempio Cinese", per presentare quella che è la realtà produttiva della Cina una volta uscita dal periodo di pandemia.

Successivamente, viene delineata la difficoltà storica di accesso al credito per le PMI, conosciuta nella letteratura internazionale con il termine "Credit Crunch". Dalla difficoltà di reperimento delle risorse finanziarie, si passa poi ad un'analisi empirica delle probabilità di default e di illliquidità per queste realtà imprenditoriali durante i mesi di lockdown.

La prospettiva di analisi si restringe e viene introdotto il concetto di Finanza Alternativa e viene inoltre rafforzato il disegno di precarietà della posizione finanziaria delle PMI ("Financing Gap") analizzando la dinamica dei loro profitti e turnover dal 2016 al 2019. La morale è che queste entità necessitano di soluzioni alternative e di diversificazione del credito e la categoria della Finanza Complementare propone proprio questo, con ben sei strumenti innovativi: Direct Lending, ICOs, Crowdfunding, Invoice Trading, Minibond, Private Equity e Venture Capital. In questo passaggio, gli stessi sono identificati nelle proprie caratteristiche e misurati per il proprio livello di popolarità come canale alternativo per raccolta di fondi.

Lo strumento dei Minibond, bottom line della nostra analisi e anticipatamente introdotto, viene approfondito in un capitolo dedicato, nel quale vengono descritte le caratteristiche di sottoscrizione, i vari players e i requisiti espliciti e impliciti coinvolti nell'emmissione. Questo strumento, nato in Italia nel 2012 a seguito di cambiamenti normativi, viene poi inserito in un'analisi pratica e reale di iniziative già attive nel nostro contesto nazionale. I creatori di questi progetti, tra i quali ELITE Group e Frigiolini & Partners, si propongono come pionieri nell'impiego di questo strumento in contesti emergenti e in altri ancora da approfondire. Tra queste novità vengono quindi analizzati i concetti di Basket Bond & Loan, le varie iniziative dei Pluribond e la recente introduzione del canale di Crowdfunding per il raccoglimento del debito, con annesse tutte le potenzialità di sostegno alle PMI in difficoltà.

Introduction

The current economic situation, characterized by the presence of the Covid-19 pandemic, presents itself as a pretext for what many experts are indicating as a worse recession than that of 1929. Unfortunately, contingencies are damaging, and warning signs are evident and seem to be confirming such expectations.

Facing a similar situation tough, there is no point in surrendering and in letting the crisis' wave unchallenged. We must stand our ground, make sure to be limiting the damage and ensuring a swift recovery to start as soon as plausible.

In this context of turbulences and unknowns, the present report proposes an analysis of causality of how these conditions spill over the Italian enterprises. The red line maintained will be the concept of financial sources diversification, as an essential tool to look after the financial health of companies. In this regard, we presume to be common knowledge the fact that SMEs, nerve centre of the Italian (and many other countries') economic-productive system, are exposed to many risks concerning financial sources and credit crunch. On this subject, therefore, in chapter 1 we will analyse with a systemic vision the current contingencies determined by the ongoing pandemic and the portrayed global recession, providing the crisis of 2007 and the much-discussed procyclicality of the bank-centric systems as the historical basis. This first part will also provide the context for SMEs around the world, and in particular for our country, and hopefully give them the spotlight they deserve. The reasoning commenced will help on drawing conclusions for the recent future and, adding to the contextualization, a small segment titled "The Chinese Example", will help us understand what continental Europe, but not only, will most likely face in the upcoming future, thanks to the data and news reported from China as the first to find a "New Normality" after the ongoing crisis.

The pretext of the problem, as we will see in full later with chapter 2, is configured in the concept of Credit Crunch (from the Anglo-Saxon definition, or "stretta creditizia" in Italian) which aggravates the cash difficulties, or illiquidity, of companies that do not meet their credit requests with traditional manners. To respond to the problem, in chapter 3, we will analyse the benefits and diversification strategies of multiple funding sources, with particular attention to the Private Debt sub-category and to the debt security industry for companies not listed on regulated markets (i.e. Minibond). The next step will therefore be to introduce the alternatives that companies have, outlining the boundaries of traditional bank lending, and thus shifting our interest towards Alternative or Complementary Finance and all its forms.

To contextualize the sector of alternative methods of financing and access to credit for SMEs, there will be a modest use of empirical data and statistics selected from highly recognized reports in the sector, such as the SAFE (Survey on the Access to Finance of SMEs) and the Cerved Credit Ratings, for which dedicated segments are provided, once again in chapter 3.

Chapter 4 serves as a development on the third and it deepens the knowledge of the Minibond. The security is therefore presented with its definition and characteristics. Advantages and benefits to issue debt in this form are listed and the actors playing in the issuing process portrayed. Explicit and implicit requirements are provided too, in order to better trace the industry.

Subsequently, in chapter 5, three interesting ideas and initiatives for the Italian Minibond industry are proposed, together with their creators. In this regard, we will look into the ELITE Basket Bond project (and following ELITE's programmes arising as this report is being written), other initiatives centred on the support of companies heavily affected in recent months, referred to with the term Pluribond, and managed by the big player that is Frigiolini & Partners Group. Then, the Crowdfunding option in relation to the Minibond security is presented, being an interesting novelty for the industry (introduced on the 10th of October 2019 with the new Consob Regulation, following the 2019 Italian Budget Law).

The topic proves to be of great personal interest to me, as well as to the financial world and SMEs. The Alternative Financing industry is proving increasingly solid and able to solve problems and fill up gaps left by the traditional bank lending channel. The innumerable possibilities introduced by these innovative tools, including minibonds, bring with them huge growth potential for SMEs that were so far neglected, helping in their development and in the variable financing needs during this process.

What the future holds for the Minibond industry and the multiple related initiatives is quite difficult to predict, and further data in required to provide plausible scenarios. The only thing that is certain, is that the segment is flourishing, and the current times bring the best environment to prove their potential and usefulness for SMEs attempting to diversify their ways of financing.

On a more personal note, I consider the topic to be very dynamic and constructive, as it has recently developed and still has most of the potential to be expressed. As an economics and finance student, with career prospects and interests in the Private Equity and Investment Banking sectors, I believe that the topic is a great opportunity and stimulus to deepen the knowledge of debt securities and financing strategies, as well as a source that provides me with sound technical notions that I am sure I will keep and use when called upon along my next academic and professional years. The competitiveness of the financial sector and the numerousness of the various financial instruments available are just two of the motivations that, in analogy with my personality and way of thinking, convinced me to undertake this path that many tend to discard. Certainly, many challenges and difficulties await me, but this first focused work gives me the strength and conditions to forge myself and to simplify my logical process in the midst of all this technical material.

Chapter 1: Current contingencies and the “Great Shutdown”.

The prospect of negative growth, a rise in the unemployment rates, and the stagnation and default of many economical activities, naturally scares everyone with a little bit of sense of maturity because it is easy to understand how the suffering of others, inevitably leads to our loss too, calling for extreme and rescuing measures from public authorities and institutions such as Central Banks. Already European countries have taken some actions, even if considered too timid and uncoordinated. On the side of a monetary policy, we can cite the Pandemic Emergency Purchase Programme [1](PEPP), announced on the 18th of March. In terms of a fiscal policy, major rescue packages for different countries must be included, with Italy at a mere €25 billion, France at €45 billion, Spain at €200 billion and the immense intervention from Germany with €550 billion. But the response with fiscal measures has been much wider. Here we include three categories of discretionary fiscal measures that have already been adopted (certainly more are being discussed as we write):

- immediate fiscal impulse: additional government spending (such as subsidizing people risking their jobs, public investment) and the foregone revenues (such as the cancellation of certain taxes and social security contribution);
- deferrals: several governments have decided to defer certain payments, including taxes and social security contributions. These measures are aiming at improving the liquidity positions of individuals and companies but do not cancel their obligations;
- other liquidity provisions and guarantees: these measures include export guarantees, liquidity assistance, credit lines through national development banks.

Here we include a table to summarize the magnitude of these fiscal measures by country as a share of the GDP.

[1] PEPP stands for a pandemic emergency purchase program, and it is defined as a temporary instrument for the purchase of securities designed by the ECB to stem the economic collapse caused by the coronavirus. The program includes the purchase of securities from both public and private sectors, for a total amount of €750 billion. It is expected to last until the end of the current year.

Table 1. Discretionary 2020 fiscal measures adopted in response to coronavirus by 15 June 2020, % of 2019 GDP

	Immediate fiscal impulse	Deferral	Other liquidity/guarantee	Last update
Belgium	1.4%	4.8%	21.9%	03/06/2020
Denmark	5.5%	7.2%	4.1%	01/07/2020
France	4.4%	8.7%	14.2%	18/06/2020
Germany	13.3%	7.3%	27.2%	03/06/2020
Greece	3.1%	1.2%	2.1%	05/06/2020
Hungary	0.4%	8.3%	0.0%	25/03/2020
Italy	3.4%	13.2%	32.1%	22/06/2020
Netherlands	3.7%	7.9%	3.4%	27/05/2020
Portugal	2.5%	11.1%	5.5%	04/05/2020
Spain	3.7%	0.8%	9.2%	23/06/2020
UK	8.0%	2.3%	15.4%	16/07/2020
United States	9.1%	2.6%	2.6%	27/04/2020

Source: Bruegel Datasets, The fiscal response to the economic fallout from the coronavirus.

There is no other way of saying that the current year, barely at its first half, has certainly been a troubled one. Plenty of events took place, but the one that we can all relate to is most definitely the Covid-19 pandemic. The virus is far from being dealt with and it took all of us by surprise. Economic systems around the world have been shaken up quite badly and a period of recession, which seemed inevitable, eventually started. The COVID-19 recession, that's how expert refer to it, also known with the names of Great Lockdown or the Great Shutdown, triggered by the placement on lockdown of more than a third of the world's population, is causing severe repercussions to the economies around the world. Timewise, the starting date is considered to be the 20th of February, when the global stock market crashed, losing 20 to 30 percent of its value and provoking unprecedented swings, due to extreme uncertainty in the markets.

After decades of steady growth, due to the measures enacted by many countries to contain the pandemic, an historical economic recession is materialising in plain sight. The IMF is reporting a more than likely drop of the global PIL of 3 percentage points during the current events and it has reported that as of the 14th of April all the G7 nations had already entered into a "deep recession" and that significant damage was to be expected for emerging economies as well.

The economic climate is devastated, with plenty of negativity. The main headlines in the mainstream channels read about:

I. An increase in government debt;
II. A downturn in consumer activity;
III. A collapse of the hospitality and tourism industry;

IV. A sharp rise in unemployment;
V. A market liquidity crisis.

And it's on the latter that we'll concentrate the discussion, starting from chapter 2, where attentions will be shifted on SMEs (Small Medium Enterprises) and privately-owned businesses, because of their exposure due to their historical dependence on the banking system as the exclusive and undiversified channel for financial support and access to credit.

Here, the intent will be to shortly visualize the frame and the importance, often forgotten, imbedded in the entrepreneurial segment of EU economic systems, so that we can understand why protecting it needs to be a priority. As the Annual Report on European SMEs (2019), published yearly by the European Commission shows, in the EU 67% of employees work in SMEs (in Italy it goes up to 79%) and these players contribute to 57% of the industrial value added (again in Italy the parameter has a bigger weight, at 68%).

Despite their disruptive relevance, the market has repeatedly misconstrued them, poisoning their environment with mistrust and shallowness. The SAFE Report (2019), again produced by the EU Commission and of which we will talk more later, brings up bewildering data, picturing a clear sense of disappointment from SMEs attempting to access credit in a traditional way.

According to the report:

- 68% of SMEs believe in "traditional bank loans" (Italy is at 58%);
- 23% of SMEs entrepreneurs believe in good chances to access capital by private equity investors (9% for Italy).

For a more macro economical assessment, a small segment about the current reality of the Chinese economy is included below.

The Chinese Example

China, first being hit by the Covid-19 wave, was also the first one entering the recovery phase and it is currently working under "close to normal" conditions. On the matter, the Economist coined the term "90% economy" to describe the level of production that China has been maintaining after the easing of the lockdown. As Callum Williams, Senior Economic Advisor of The Economist, suggests, the picture being depicted is of a more solitary and less fun society, where people got back to normality only in a partial way, respecting their duties, by going to work, but keeping a reluctant behaviour when it comes down to social and outdoors activity.

An analysis cited by Mr. Williams in his remarks, finds that weekday subway trips in China have recovered to a greater extent than weekend ones.

The “New Normality”, that is an appropriate appellative for what to expect. Social distancing measures are here to stay, and the uneasy mentality of the clientele is going to be extremely hard to revert, affecting the hardest those sectors directly linked to immediate consumerism and/or seasonality such as hotel occupancy, and other tourism-related businesses.

Evidence from the comparison between Sweden and Denmark suggests that it is people’s voluntary decisions of how to behave that are shaping the economies, more than what the government is telling them to do. Countries need to prepare because the worst effects are yet to come, and a huge wave of bankruptcy and insolvency is to be expected months after the easing of the lockdown (as China showed). The longer we will have to wait for a vaccine and the more pronounced the effects of the “90% economy “ will be.

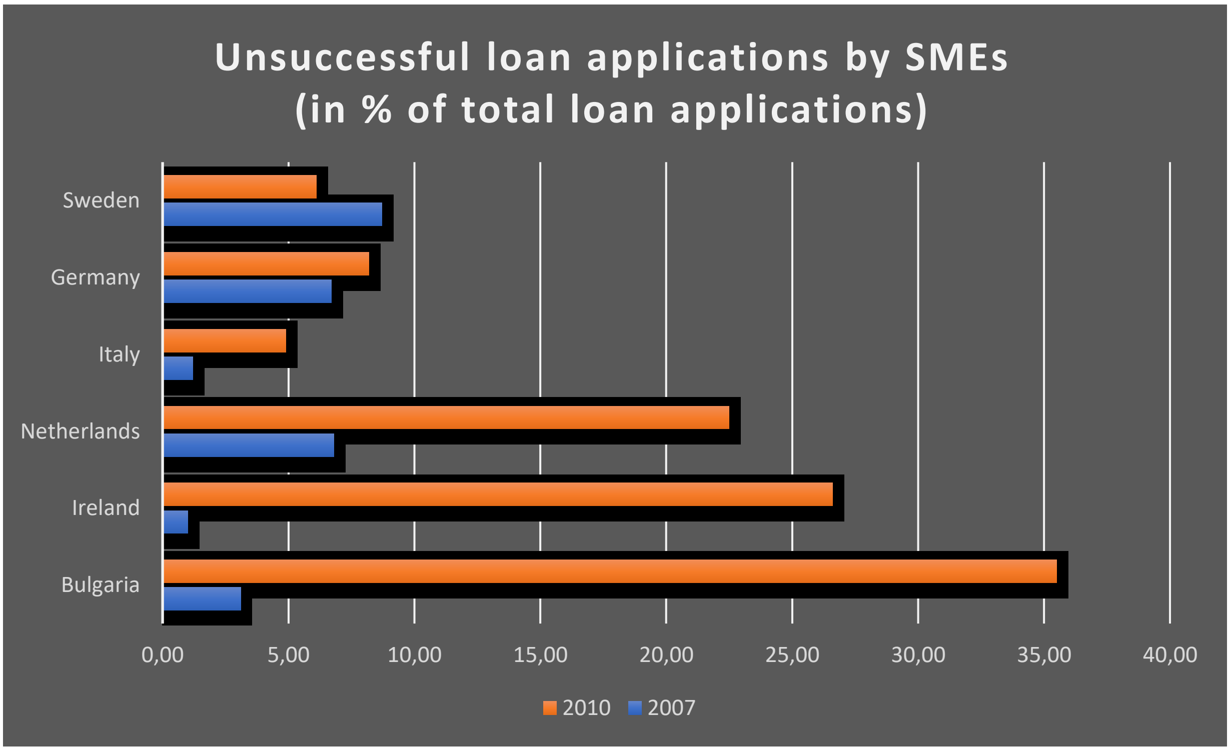
Elementarily, no permanent solution is easily obtained and SMEs are asked to take a half-blinded leap of faith and trust the “new experts”, as they did before with the bank system, but with some major difference: the financial innovation is on their favour this time, there are no smart gimmicks to marginalise them, but an honest attempt by fintech companies, that in fact are sharing most of the problems, to cooperate and support each other and their operating among the economic systems around the globe.

An important premise before reading on is that the data and considerations shown in chapter 3, when discussing the six innovative ways, are there to provide simple expectations regarding the various tools, and they need to be considered carefully, due to the highly unstable conditions in which they are being applied. The conditions are quite extraordinary and forbid a real forecasting. Nevertheless, the industry of Minibond in particular, has shown prosperous results and a great trend of growth over the years. But we shall discuss this shortly after.

Chapter 2: Credit Crunch, a persisting issue for SMEs.

The banking system with its many services, including the main one with the loan of capitals (e.g. bank loans), has always been the "normal" way of supporting businesses' growth cycles, but it shouldn't be the only one. Just about a decade ago we have seen the precarity of this financer, leaving the most fragile companies helpless and exposed, almost exclusively for their size and that sense of untrustworthiness around them. Taking from the statistics of the Eurostat (Eurostat, 3rd of October 2016, Eurostat news release 144/2016), we can see the proportion of the failure by looking at the number of unsuccessful loan applications by SMEs after the 2009 economic crisis. Data shows that the unsuccessful requests rose between 2007 and 2010 in 19 of the 20 Member States for which this data is available. The highest percentages recorded were found in Bulgaria (36%), Ireland (27%) and Netherlands (23%), with Italy in the red as well but just slightly (at 5%) according to this analysis (Sweden was the sole exception to the trend).

Chart 1. Unsuccessful loan application by SMEs in different countries.



Source: Eurostat, News release 144/2016, Euroindicators.

Consequently, a topic of discussion took the stage and experts directed their research on the Diversification of Credit (Hacioglu, Umit, Dincer, Hasan, 2017, *Global Financial Crisis and its ramifications on Capital Markets).* The term, well-known in the industry, refers to the process of allocating or borrowing capital in a way that lowers the exposure to any individual asset or risk. By doing so, a company, in particular a SME, is able to rethink the ways it seeks credit, experimenting alternative channels and using diversified providers in order to reduce volatility by compensation of risks. We need to keep this in mind because it is going to be a recurrent concept along the analysis (mainly chapter 3) and it expresses the best chance smaller companies have for escaping the Credit Crunch that afflicts them.

The spark that started the flames was the liquidity problems that millions of SMEs encountered following the Great Recession of 2009, and that brought most of them to their knees (170 thousand small businesses just in the US, G. Scott Thomas, The Business Journals). The struggle is recognised in the existing literature with the term "Financing Gap", (OECD handbook "The SME Financing Gap Vol.1", 2006) and the reasons for its happening are many and they all come down to the fact that capital providers (e.g. banks) require transparency and accountability from the borrower. First, the SME's sector has a larger variance of profitability and growth than bigger enterprises. Second, they show greater yearly volatility in earnings and a lower survival rate. In addition, smaller companies in the manufacturing sector, leader between the SMEs', have been proven to be 5 times more likely to fail than larger firms (OECD, The SME Financing Gap, page 20). Finally, structural rigidities and distortions of the functioning, exacerbated by the network of mostly personal relationships and the confusion between ownership and leadership, end up spoiling the transparency and the trustworthiness of these smaller companies. Financial institutions, as providers of credit, understandably protect their interests and because of that, they prefer to support larger enterprises that are most likely going to get through the difficulties and resolve their debts.

Diversifying the sources of credit should be a priority for companies because it allows to have a safer and much more stable inflow of capitals, other than contributing to ameliorate the accounting documents (i.e. in the income statement where passive interest on loans and other direct costs for financial services are attributed). But data shows a general diffidence and a non-existing change of attitude from 2006 to 2015. In this window of time, according to Crif Ratings, in Italy just 5% of companies have diversified their sources and the banking debt has stayed around the 85% mark. And the comparison with other countries is even more alarming considering that in Italy the banking credit accounts for more than two thirds of the financial debts of enterprises, whereas in France and Anglo-Saxon countries it stays at one third and in Germany at one fourth (Crif Ratings, December 2016).

2.1 ARISK Analysis on the effects of the Coronavirus on the current assets of SMEs.

Now, at the verge of a new crisis, the situation seems unchanged and the small ones are again at the centre of the storm. ARisk S.r.l, an innovative start-up based in Milan and partnered with the Politecnico of Turin, has been trying to assess the effects and the risk of the Coronavirus on the current assets of SMEs. From their results we can visualize the seriousness of the exposure for these smaller players.

At the opening of their last report (March 2020) they explain how they have divided the sample into three categories based on revenues: Category A from 1 to 5 million euros, Category B from 5 to 10 million and Category C from 10 to 15 million. From their findings we can see that just after 15 days, the tiniest companies have burned 103 thousand euros in current assets (or cash), for group B it moves at 300 thousand and group C shows the biggest figure with 450 thousand euros. But what worries these analysts is the fact that for the weakest ones, in the first partition, none is left and their resilience is coming to an end, aggravated by the fact that in Italy a merely 10% of enterprises buys insurance for business continuity, an extremely useful defence in these instances because it would cover for their financial needs in times of necessity.

The picture is as clear as water and these companies need a centralised response from the government, avoiding static measures that simply delay the nearest tax duties, for instead better ones that are aimed at tax incentives that could help production in the second semester of the year, in addition to temporary funds in support of the cash flow and working capital of companies in need.

Certainly, a public help won't be enough, and we will see what other solutions are available, but it would still go a long way in easing the strain on these enterprises.

2.2 Cerved Rating Agency and Default Analysis for 2020

Cerved Rating Agency is the Italian rating agency specialized in the assessment of the creditworthiness of Italian non-financial companies and the issuance of debt securities. Thanks to a team of more than a hundred analysts, the agency issues and monitors internationally recognized public and private ratings, always with Objectivity, Integrity and Transparency (Self-presentation, Cerved Rating Agency's website). On the last report, the CRA opens by saying " One out of ten, that's how many companies will shut down if the coronavirus isn't solved by the end of the year". Luckily, the worst part of the emergency is reported to have been contained well before that terrorizing deadline, but the "soft scenario" predicted by the agency is still a cause for concern. Regarding the “soft scenario”, their findings show a probability of default of 6.8%, with a swing between 2.7% and 10.6% depending on the sector of activity. The scenario also predicts a 36 months window for a recovery, during which the cost of production is expected to rise substantially, with a general worsening of the net working capital and an increase of the short-term liabilities such as current debt. The window also acts as an ultimatum for a restart, and damage to the local and national economic system seems inevitable after that point.

2.3 Invoice Trading, an autonomous first-aid kit from fintech.

As we have said, the Italian banking system reduces loans depending on the expectations on the trend of the economy. But small and medium enterprises need to have positive cash flows regardless of what financial providers expect, and the fintech platform introducing the Invoice Trading, is a first useful solution in that direction. Using the instrument, companies have the autonomous option to assign without recourse invoices not yet collected through the use of digital platforms, which allow them to manage sales operations directly online, offering clear advantages also in terms of timing, being that, from the application on the platform to the disbursement of liquidity on the company’s account, it takes only six days, compared to the standard sixty required by traditional banks for advance invoices.

The benefits for the companies’ balance at the year-end financial statements include:

- Immediate liquidity usable to reduce their net financial exposure and a better access to bank loans thanks to an improvement in the main parameters evaluated on the base of merit for credit (net working capital and net financial position);
- Thinning of the NFP: The Net Financial Position, defined as the difference between financial liabilities (current and long-term) and cash and current assets. The assignment of receivables, with the related fast liquidity entry, eases the NFP and improves, as we said already, parameters demanded by the covenants required in order to obtain bank loans;
- A third advantage is the deductibility of the cost calculated from the difference between the nominal value of the receivable and the definitive purchase value for the investor.

As of the end of 2019, the sector has traded more than €1.5 billion, of which €939.3 million in the last 12 months, an improvement of +91% compared to the previous year. It is still important to notice that the cycle of investment in this field is quite short, where commercial invoices with maturities of just four months, are mainly used for operations of securitization ("cartolarizzazione") and for that, the invoices are reinvested multiple times during the 12 months period.

Nonetheless, this channel of financing has been used by a great number of SMEs and it is expected to perform better in the future. As an additional remark, this sector is the only one of the 6 channels of Alternative Finance that is in line with the European statistics and figures (the six tools of Complementary or Alternative Financing will be explained in the next chapter).

All considered, the Invoice trading proves to be a real helping hand for struggling SMEs, but it still doesn't solve the major problem of finding a reliable and consistent financial support for such companies. In the next chapter we will focus on the hearth of the discussion, opening again briefly with the concept of financial diversification and then moving on to the fields of Alternative Finance and Private Debt.

Chapter 3: Alternative Financing and SMEs access to credit.

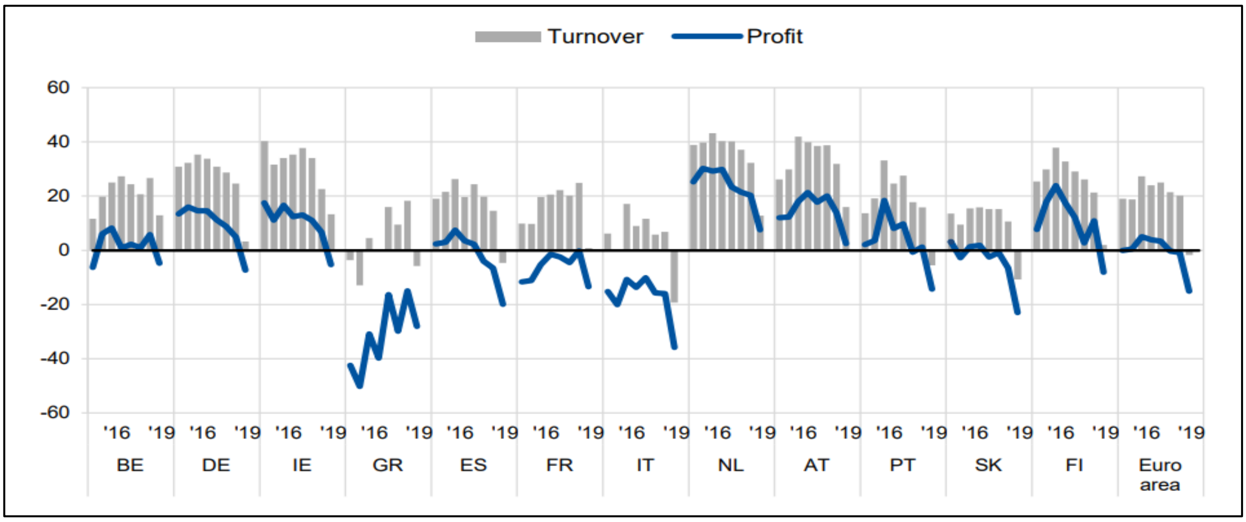
3.1 The pretext and the access to credit.

As it was anticipated, it is now time to discuss the alternatives that SMEs have to satisfy their financial needs, especially in times like these, when financial providers are more and more strict and selective in choosing the borrowers.

The scenario that we face shows small and medium-sized enterprises that are turning to non-bank financing sources at a faster pace than ever recorded, and this phenomenon has at the core a rapid deterioration in the economic environment, despite the enlargement of accommodative financing conditions. This statement finds empiric support from the SAFE Analysis for the Survey on the Access to Finance for SMEs (2020). In their latest report, referring to the period from October 2019 to March 2020, their team of analysts and experts have listed a couple of red flags:

- for the 1st time since 2014, euro area SMEs signalled a decline in turnover (-2% from a +20%) with the three worst findings for Italy (-19%) , Slovakia (-11%) and Greece (-6%). Nonetheless, the deterioration was widespread across countries with two exceptions in Germany and France, as we can see from the table 1 below;
- consequently, a sharp decrease in profits appeared too (-15% from -1%);
- most importantly, an enlightening indicator of the financial situation for the sample, suggests that 4.7% (from 3.1%) of euro SMEs faced major challenges in running their business and servicing their debt, worsening their credit rating and their balance sheets' parameters for creditworthiness.

Chart 2. Change in turnover and profit of SMEs across euro area countries



Source: Survey on the Access to Finance of Enterprises in the euro area - October 2019 to March 2020

The latter point carries the highest message of why this category of economic players is turning its back on bank loans and prioritizing the many alternative and innovative instruments that the financial market currently provides.

3.2 Alternative financing

The buzz word in the title says it all. SMEs and entrepreneurs are wounded and are on the lookout for new and more flexible solutions. The term “alternative or complementary finance” grew stronger in the years following the Great Recession started more than a decade prior, when weaker players found themselves abandoned or even oppressed by a financial system that didn’t indulge in their needs.

The result was that the market filled in where needed and it came up with new instruments and ways of reaching external finance. Governments reacted as well, fostering the SMEs’ access to bank and alternative sources of finance by adapting regulations and introducing specific policies to support the Fintech sector (source OECD journal, Newsroom).

So, the result was that enterprises started discovering new ways to access credit and preferred these ground-breaking instruments because of their different requirements and evaluation criteria, releasing them from the burden of untrustworthiness cemented by the banking system. Minibond for example, when assessing debtors, refuses traditional criteria of financial position and collateral, to give instead a bigger importance to capital strength, profitability and cash flow. This allows for a fairer playing field, where SMEs too can show great prospects and sustain their growth.

As an anticipation we have already presented the Invoice Trading instrument, but many others belong in this field. Let’s expand on these.

The six tools

In literature six sub-categories of innovative financial instruments are found and they are:

- Direct lending;
- Invoice trading;
- ICOs and token offerings;
- Private equity e venture capital;
- Minibond;
- Crowdfunding.

For this report's specific scope, we will concentrate the analysis on the Private Debt instruments (Minibond, Direct Lending, and partially Crowdfunding. On the latter statement I will explain myself later on). Nevertheless, a short presentation of the full package seems appropriate.

To present them, we need to first explain their differences using three factors: form of financing (debt, equity, reward, assignment of invoices and digital tokens), time horizon (short, medium, long, custom and variable) and the type of typical investor (bank, professional, retail).

Borrowing the table from the Politecnico di Milano a useful summary is provided.

Table 2. Characteristics of the various financing forms

	Form of financing	Time Horizon	Typical Investor
Direct Lending	Debt	Medium	Professional
Invoice Trading	Invoice assignment	Short	Professional
ICOs and token offerings	Digital Tokens	Variable	Retail
Private Equity and Venture Capital	Equity	Long	Professional
Minibond	Debt	Medium and long	Professional
Crowdfunding	Reward, equity and debt	Custom depending on form of financing	Retail and professional

Source: La Finanza Alternativa per le PMI in Italia, 2° Quaderno di Ricerca, November 2019.

ICOs, PRIVATE EQUITY AND VENTURE CAPITAL

With the ICOs (Initial Coin Offerings) it is possible to collect capitals on the Internet by offering digital tokens in subscription and by removing intermediary platforms and traditional paying systems. The crypto currency market has brought a bit of a revolution in the financial market, but despite that, the upcoming future for this tool seems to be negative, due to the high volatility in prices and the strict intervening of market authorities, especially in the USA.

Private Equity and Venture Capital follow a different line of business. Professional investors in this segment subscribe risk capital in companies that are not yet listed and that show great ambitions of growth. The ideology behind these financers is their attempt to contribute to the growth of these newly started companies and to profit from a capital gain when exiting the position (i.e. with the disposal of the equity investment with the sale to third parties or with the listing on the Stock Exchange). Adding up all the different peculiarities of sub-channels of these two categories (early stage financing, expansion financing, buyout) the volume of the sector is of €1.19 billion in the last 12 months (+116 % compared with the previous year).

PRIVATE DEBT

A. MINIBOND

The industry of the minibonds is growing steadily in Italy since 2013 when the regulatory amendments started with the D.L. “Sviluppo” and following decrees have loosened up the segment and created new opportunities for SMEs in issuing debt and commercial papers (“cambiali finanziarie”) on the market, subscribed by professional investors (funds and asset managements companies). The figures for the sector showed €756 million in principal value of the issues for the last economic year and €1.13 billion for the previous one. The last numbers seem controversial when considering the “steady growth” stated at the opening of the paragraph, but the two figures took into account reimbursements, which have been conspicuous in the last year, consequently lowering the number reported. Nonetheless, the numbers speak for themselves and they highlight a great volume of investments and transactions in the last years, giving confidence for the upcoming future, also because of the opportunities that will come from the operations in the system of “basket bonds”. The term refers to the innovative opportunity of collecting bonds with similar categories, with the exceptions of amount and covenant, into a unique subscription made by a Special Purpose Vehicle, as a great possibility to invest in the real economy, represented by SMEs issuers of high quality (we will expand on this in our last chapter reserved for real practical cases and examples, where we are going to present the Italian initiative of ELITE Basket Bond).

For the purpose of this segment, the topic of Minibond is going to be thoroughly discussed in the following dedicated chapter.

B. DIRECT LENDING

First, what is it? By definition, it is a form of corporate debt provision where lenders, non-bank providers, make loans to companies, without the use of intermediaries, and with the objective of growth or acquisitions.

Considering the fact that mainstream banks are reducing the supply of loans, new ways of finance have emerged, especially these forms of peer-to-peer (P2P) and new asset-backed providers that have proven their usefulness in the field of smaller loan sizes. For this reason, and mainly the change in regulations that has reduced the relevance of banks to SMEs, private lenders of this sort, came into play and proved to be well suited to carry the burden that traditional creditors have so dramatically violated.

Still undeveloped, this segment hasn't received much attention for the time being, and it stays only marginally selected by SMEs (around €8 million in the last annual period, two times more than the figure for the year before). Direct lending by private funds in Europe runs at about 1500 transactions a year, according to the industry figures, but it needs to be said that tracking deals with smaller companies is quite complex to do accurately. Despite this, a future growth is to be expected because of newly announced specialised investment funds that promise well in that direction and the speed and flexibility that this options carries.

C. CROWDFUNDING

The term refers to the process of collecting small amounts of money from a larger crowd of individuals in order to finance a new business venture. Groups of people pool together and raise capitals from small participants so that the company or project can get off the ground.

This tool started simultaneously with the Minibonds (and we will discuss their marriage later on in the practical cases chapter), and it has seen an excellent growth rate in the next months, probably thanks to the eventual opening to all SMEs, initially excluded from an opportunity that was reserved to start-ups and Innovative SMEs. It is important to point out that when discussing the subject, a distinction between three terms, indicating sub-categories, is necessary. The lending (or debt) crowdfunding distributes the amounts collected from privates or companies to all the different creditors, as an attempt to dilute the risk together with the return/yield, while the equity crowdfunding consists of the direct investment in a sole reality, trying to capitalise the return/yield from that one unique financial operation. As a third and substantially different option, other than evidently smaller, we also have the reward-based crowdfunding where companies collect funds through the offering of products and non-monetary rewards.

The figures for the three options are the following: for the lending segment we find €84.2 million in value of capitals traded compared to the €44.7 million of the previous year (+88.4% change), the equity one went from a €20.9 to €49 million (+134.5% change). The reward choice isn't as promising as the other two and it seems to be stationary with €1.5 million on both years[2] (La Finanza Alternativa per le PMI in Italia, page 8, 2° Quaderno di Ricerca).

[2] All figures presented refer to the flows of financing through the use of alternative channels for SMEs and the time reference shows the comparison between the 2019 and 2018 annual periods.

Chapter 4: The minibond: definition and peculiarities

4.1 Definition, benefits and risks

Minibonds are medium-long term debt securities (bonds and commercial papers) issued by privately held SMEs, i.e. non-financial companies that employ more than 10 people and present an annual turnover and/or asset in excess of €2 million. Also, the maximum size of €50 million is not a real limit but only a presumed maximum capacity for a SME issuer. (Osservatorio Minibond, 2020, Italian Minibond Industry Report, Milano). The main novelty is the fact that these bonds can be issued by small and medium enterprises (which is what gives them the term "mini") without necessarily the assistance or mediation of bank/financial third parties. The subscription instead, is reserved to institutional professional investors or other investors with comparable qualifications of professionality.

For the Italian market they were launched in 2012, according to D.L. 83/2012 (the so-called "Decreto Sviluppo"), in reaction to the restraints in the traditional bank financing resulting from Italy's double-dip recession[3]. For Italy that period was the 2007-2013, which showed a capacity reduction between 11 to 17 percentage points, depending on the sector of activity.

Behind the consolidated balance sheets of these companies choosing the segment (AIDA-BVD database, *Motives declared for issuing minibond*, N=536 companies), we find several motives. The most popular one is the internal growth, followed by financial restructuring and cash necessities, intended as the magnitude of the quick ratio and other liquidity indicators.

BENEFITS AND RISKS

In between the many advantages that issuing a minibond brings to the issuer there are:

a. debt diversification. Channel complementary to bank's credit;
b. tax incentives with deductibility of interest expenses up to 30% and deductibility of issuance costs in the same year in which they are incurred;
c. brand promotion through a sort of marketing event and a sort of business model certification by the financial market which audited the regularity of the issuer;
d. more control over financial strategies;

[3] The latter term refers to a definition given to a range of time during which economic activity goes down, increases slightly and then drops again.

e. engage with sophisticated investors, acquire new skills on financial markets and be better prepared for potential follow-ups in more complex deals (e.g. private investors to access share capital, or listing on stock exchange)
f. a solution to enhance equity value of the enterprise reaching a better liability structure and consequently improving the parameters investigated by financial provider for conceding loans;
g. a natural certification of transparency and trustworthiness.

On the other hand, the industry isn't risk-free, far from it actually. Certainly, the security offers appealing yields (around 5% net), especially now that State bonds and big corporate bonds offer such low interests. Still, because of the rigidity of the system and the uneasiness of negotiability, holding debt in this form carries a heavy burden of immense volatility, that doesn't go well with emotional investors that get easily influenced by the swings in prices and returns. This explains exactly why the restriction to retail investors is imposed for the time being.

4.2 THE REQUIREMENTS

In order to access the segment of financing, companies need to comply with some specific requirements, that are:

i. Issuer is an Italian company, not interested by bankruptcy event or arrangements with creditors;
ii. Issuer is not a bank nor an insurance company, nor an asset management company supervised by market authorities, nor a Shell Company just for an acquisition or securitization of a deal;
iii. Issues lower than €500 million (cumulated value of any issue by the same company in the same month);
iv. Minibond is not convertible into equity capital and it's not listed on a regulated exchange, open to retail investors.

Nonetheless, as experts suggest, in order to issue a Minibond, there are also implicit requirements as to do it effectively. The company is advised to comply with the following steps:

- acquire a skilled management;
- develop a solid Business Plan;
- preferably ensure a valuable position in the market and hold a competitive advantage;

- maintain an international mentality, priceless for a potential next step in the growth process, trading publicly.

THE PLACEMENT AND PLAYERS IN ISSUING THE SECURITY

The financial product is traded on the ExtraMOT Pro3 (successor to the original ExtraMOT Pro), a segment of the Borsa Italiana, developed for the listing of bonds, promissory notes, project bonds and commercial papers. The listing process is flexible in terms of admission and disclosure. No formal listing prospectus is required and a simple admission document must be filled in with the main financial information regarding the issuer, the relevant risk factors and the main terms and conditions of the debt instrument (some other minimum requirements apply, such as the presentation of financial statements for the last two financial years, the latter being fully audited). The disclosure side includes the publishing of the audited financial statement, the rating (if any present), and providing any additional information regarding changes to the rights of bond holders or in the terms and conditions of the debt instrument.

Finally, we will look at the five players and their role in the issuing process.

1. The Auditor ensures and certifies the regularity of the balance sheets and financial information.
2. The Advisor assesses the feasibility of the transaction and prepare the business plan.
3. The Legal Consultant verifies the compliance with regulation contractual terms.
4. The Arranger manages the capital market placement and investor relation.
5. The Rating Agency certifies the company’s solvency and recovery value.

Big players such as Unicredit and BNP Paribas, offer a comprehensive service providing for multiple of these roles, knowing that the size of their clients interested in issuing the obligation forbids them from autonomously manage the process due to the highly skilled and qualified experts required by law.

FUTURE EXPECTATIONS

Regardless of the challenging situation we find ourselves in, experts in the Minibond segment suggest a positive trend of growth in the rest of the year 2020 (Osservatorio Minibond, 2020, Milano). Their previsions don’t rely solely on data but also on macro movements of the economic environment. Among all the uncertainty three tendencies seem to be prevailing and they deserve to be included. Firstly, a great deal of activism is being recorded among public entities (Regions and Chambers of Commerce) in promoting the instrument and in ameliorating the relationship between these smaller players and the Capital Markets. Secondly, the investor's side is acting up as well, asking for better opportunities to invest in the real economy (which is the bottom line of investing in Minibond). At last, the novelty introduced with the opening of Minibond issues to crowdfunding platforms[4] provided new ground for movements and experts seem hopeful in his continuous success.

[4] The topic will be thoroughly discussed in chapter 5.

Chapter 5: Solutions and Italian initiatives for the Minibond industry.

As anticipated, the interest of our analysis was about the Minibond and how they are perceived in the Italian economic system. To this aim, we considered appropriate to provide a funnel-structured context of everything that rotates around the financial instrument in discussion.

At this point tough, our perspective is going to be focused exclusively on the Minibond and how it could be useful (and many initiatives already on the way are in support of this claim) in repairing the damage brought by the pandemic affecting us all. For the purpose, real players with interesting initiatives and projects will be presented in the following pages, and their potential implications evaluated as well.

5.1 ELITE Group – London Stock Exchange Group

5.1.1 BASKET BOND & LOAN

Elite is a private market of integrated services and multi-stakeholder network, part of the London Stock Exchange Group (LSEG together with Borsa Italiana). It is recognised as an ecosystem committed to the success of global scale up businesses (1100 businesses joined the network as of the end of year 2019). It was first launched in 2012 and since then it has become a global community with the mission and vision to provide companies access to capital, skills and network needed to scale up and make a lasting economic impact ("About Us", ELITE website).

In December 2017, the company launched the first Basket Bond, an innovative solution to support access to financing for the high-growth, high-performing companies within the Elite programme. The project was designed in partnership with Banca Finint and it includes ten companies (between them we find Peuterey, the famous brand of clothing and expensive apparel, and RDS, the radio broadcasting company) for a total issue of €122 million ten-year bond.

The initiative seems to be an isolated help, with little use for the most general audience made of SMEs. But the reality is right of the contrary opinion. The ELITE community provides insight and guidance to any enterprise willing to ask for help. Also, they acted as a pioneer for initiatives of this calibre, easing the terrain for all situations alike. As stated by Cornaglia Group, one of the ten companies included in this first batch of Basket Bond, "This was something that was not just to us, but to the market – something unique [suggesting that the project has brought plenty of intangible benefits too]" ("ELITE Basket Bond: la raccolta fondi del futuro", paragrafo “Le stelle di domani”, Elite-network.com, online article). The key feature that makes the Basket Bond unique from traditional fundraising vehicles is the mutual guarantees offered by the companies taking part, just like a network made of strong and collaborative linkages that support each other’s burdens. All these features seem to suggest a prosperous future for the community and its ideas.

What was previously presented as a prediction or an expectation, has eventually become reality.

On the 24^{th} of June 2020, Elite, FISG (Banca Finint) and ADB Corporate Advisory have launched the Basket Loan. The instrument belongs to the rescue measures enacted by the Italian Government for the Covid-19 emergency (e.g. “Decreto Cura Italia”) and it has the objective of carrying, in a concrete and diversified way, new liquidity from the banking system to the Italian enterprises suffering. The initiative is supported by the specialised competences brought by FISG in the role of the Arranger. The process is fully digitalised, with a dedicated landing page (e.g. http://basketloan.it/) and it has received the “Covid-19 Certificate as part of the package of services with an informative purpose during these troubled months.

5.2 FRIGIOLINI & PARTNERS MERCHANT

F&P Merchant is born in 2015 as an innovative start up by the initiative of its then founder and current CEO, Leonardo Frigiolini. Shortly after, this first company becomes the main branch of an immense group that focuses on the all-court support of enterprises, especially SMEs, in reaching the innovative markets of private debt and equity, following the ditch of possibilities created by the 2012 D.L 83/12 and 179/12 around the field of Fintech. The Group is composed of the parent company that is M&P Merchant, operating in the creation and management of fintech platforms and in the direct assistance to companies accessing the world of innovative finance, Funder Srl, managing an equity crowdfunding platform authorized by the Consob, and finally F&P Insurance Broker Srl, again an innovative start up, operating in the sector of the insurance brokerage.

On the specific topic of the Minibond, M&P Group is leader, with 100% of the issues, and founder of the “Short-Term”™, which are minibond with a maturity of no more than 12 months. Thanks to the amount of assisted operation, the Parent Company has been declared by the “Osservatorio Minibond del Politecnico di Milano” as the Leader Entity in Italy for the number of minibond listed on a regulated market and issued by SMEs.

PLURIBOND

In March 2020, F&P Merchant and the controlled Fundera have announced the structuring of two Pluribond in support of the companies located in the most heavily struck areas by the coronavirus (Lombardia, Emilia Romagna and Veneto). The two projects are referred as "Pluribond Liquidity Provider" and "Pluribond Restart Italy". The first instrument is aimed at providing the necessary liquidity to companies as quickly as possible, fundamental to guarantee business continuity; the second, less urgent but equally important, it aims to move over time, through the resorting of a long term minibond (3-5 years), the overall cost of the production impasse suffered (Genova, 10th of March 2020).

In short, the first measure is finalized in feeding the cash necessities, while the second is concerned with spreading in time the accumulated cost registered in the last months.

The placement of the two initiatives will happen on the crowdfunding portal Fundera, thanks to the new discipline introduced by the Budget Law of 2019 and the modification approved by the Consob regulation 18592/13 of the last 10 October. The novelty is the fact that before capitals couldn't be collected through crowdfunding, or on-line portals in general. Further argumentation is advanced for the topic of crowdfunding in the following segment.

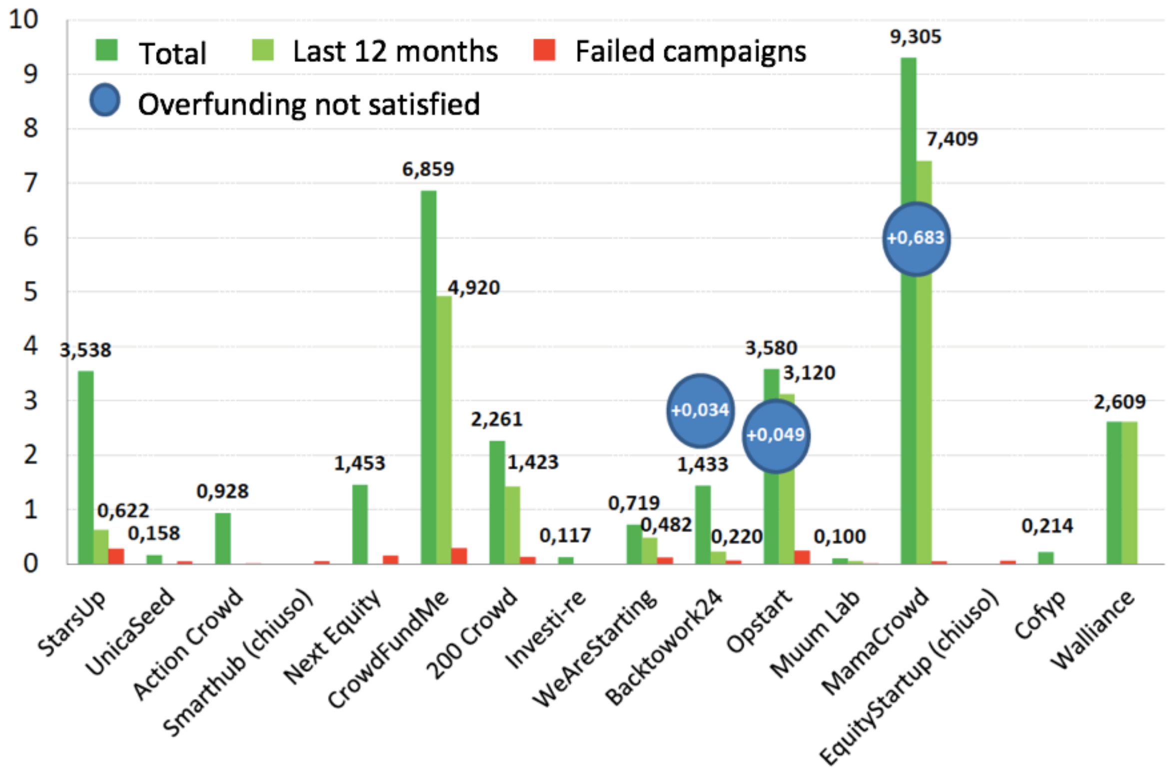
5.3 CROWDFUNDING AND MINIBOND

Where did it originate?

Crowdfunding platforms are quite common nowadays, with names like GoFundMe, Kickstarter, Patreon and many others, that are employed for the most various purposes.

Still, the framework behind it isn't new and although it represents a unique way of fundraising, it draws inspiration from concept like Microfinance and Crowdsourcing (Mollick, 2013). The basic idea isn't revolutionary, but its application is. Thanks to the coming of several disruptive events such as the Web 2.0, Crowdfunding turned into an innovative financing mechanism.

Chart 3. Capital raised up to the end of year 2018 by Italian crowdfunding portals authorized by CONSOB. Values are expressed in millions of €.



Source: Consob, 2018, Equity Crowdfunding: a review of current trends, Consob documents.

Bottiglia and Pichler (2016) defined Crowdfunding as a new phenomenon which enables people from the crowd to fund a project or an idea, they share an interest in, by using an online platform. Still, the author's point of view remains unclear regarding the precise factor that lead to the boom of this segment. What is certain is that the Internet revolution in its second generation together with the 2007-2008 crisis made a big contribution in the process. The latter denotes how this innovative way of funds seeking has emerged as a response to inefficiencies of capital markets which tended to over-complicate and marginalise categories of investors altogether.

The novelty: Minibond traded on CF platforms.

The 18th of October 2019 Minibond have landed on crowdfunding platforms. On that date, the Consob[5] has approved the modifications in the Regulation introduced with the norms in the Budget Law 2019 for the financial segment. This allows for crowdfunding portals to offer not only capital equity, like shares or stocks, but also bonds and other debt securities.

[5] CONSOB is the Italian Institution for protection of investors and supervision over regulated markets.

Nonetheless, the Italian regulator has chosen to limit the access to this new segment, and so it is still restricted to many investors, opening only to three specific categories of retail investors:

1. Individuals that hold a financial portfolio (including cash and deposits), of at least €250 thousands.
2. Everyone who commits in investing at least €100 thousand in a single subscription.
3. Retail investors that operate as professionals in the field of financial services such as Portfolio Management, Investment Consulting, Wealth Management and so on.

The idea behind these three limitations is an attempt to counterbalance the substantial risk imbedded in the debt investment itself. By limiting the access to individuals with experience or/and a great financial stability, the regulators intend keeping conservative investors away from this volatile environment, in order to protect them from themselves.

At this point in time CF is everywhere and tens of platforms already exists, and they are employed for the most various purposes. But not all of them offer Minibond. Among those that do, we find Fundera (as we have discussed in the previous paragraph), the pioneer of the sector, being the first equity crowdfunding to offer minibond issued by SMEs, but ready on the start line we have Backtowork24,Crowdfundme and Walliance, in addition to others that are still discussing the topic, for instance 200Crowd and Starsup (Osservatorio Minibond, 2020, Milano).

It is still important to highlight why was this step taken, because everything has a reason and we can learn something from it. The timing is the answer. Again, as it was with its first appearance, it is no mere coincidence the fact that the update happened during a negative financial context where most returns showed infinitesimal rate even for medium-long term maturities in State and Corporate Bonds for the Eurozone and the market has once again bureaucratised. The market is shifting towards a riskier set of assets, in order to satisfy its appetite for yield and its desire of proximity in investing. The latter refers to a common trend appeared in the last couple of years, where investors tend to prioritize their operating in between national, or at best continental, borders. By doing so, investors consider their positions more transparent and, could be, safer.

Now again, the law of the market are clear, higher returns require greater risks. That said, the discussed segment of market is already proving its potential in being a further opportunity for SMEs looking for resources to sustain their entrepreneurial projects and the centralised institutions have noticed it. In fact, it is quite meaningful the effort made by the European Commission to establish and environment and policy framework where the alternative forms of financing could flourish. In this direction, the EC has approved two funding programs for SMEs in 2014-2020 period: Horizon 2020 and COSME. The former represents the biggest EU Research and Innovation program ever with nearly €80 billion of funding distributed over 7 years (European Commission 2017a), while COSME is the EU program for Competitiveness of Enterprises and Small and Medium-sized Enterprises, that relies on a planned budget of €2.3 billion (European Commission 2017b).

The two aim at improving the access to finance for SMEs in the form of equity and debt, improving the framework conditions for the competitiveness and sustainability of EU enterprises and finally for promoting entrepreneurship and entrepreneurial culture.

Conclusion

The purpose of this analysis was to neither endorse nor reject the world of Alternative Finance and in particular the Minibond solution. As said in the opening lines, the structure of this report and the logic behind it resembles a funnel, going from a wide and macro-economic point of view of the economic environment to end up on the specific topic that is the Minibond and all the related initiatives currently taking place in our country.

The core and causal point of all these vicissitudes is the fact that tendencies change, and the economy advances regardless of any individual action. SMEs, as a category of players repeatedly misconstrued by the financial system, has shown many of these mutations in an attempt to ease their financial situation and has embarked on a journey across the world of Alternative Financing.

Nonetheless, none of this would have happened just with one side of the medal agreeing on it. “If Crowdfunding is an innovative way of funding enterprises, it is an even more innovative way of investing” (Bottiglia, Pichler 2016, p.56).

The side of the offer, traditionally occupied by bank loans, has been enormously privatized and investors willing to put their capitals somewhere got bored of the infinitesimal rates offered by State Bonds and bank-related investments. The market got enthusiastic once again, embracing these novelties and the timing couldn’t have been better. The current situation with a new economic crisis spreading from country to country, brought cause for concern for the general public but also “reckless” opportunities and big appetite for sensible returns for expert investors and practitioners that desire a riskier set of assets to invest in.

The findings of these analysis suggest a dynamic but prosperous set of opportunities for companies on the demand and investors on the offer that are intertwined in these new solutions. Subsequently, SMEs have managed to reverse the trend and reduce their dependence on traditional sources of credit, with FinTech initiatives that have accounted for 36% of the total amount of capital borrowed by these smaller companies. The banks, traditional villain of this story, have reacted and they have updated their operating and are starting, or already have, to offer these sources of credit directly or indirectly with auxiliary services such as those offered by Unicredit, considered the leader institution in the Capital Markets for SMEs, and awarded for it at Milano Finanza Global Awards 2018.

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