

The Relationships between Companies and Bank System: An Analysis of Italian Context

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Received: June 21, 2017

Accepted: August 30, 2017

Online Published: September 9, 2017

doi:10.5539/ijbm.v12n10p1

URL: <https://doi.org/10.5539/ijbm.v12n10p1>

Abstract

The purpose of our research is to propose to model which could suggest to Italian small and medium companies the best appropriate funding resources to their economic and financial situation. The framework of this paper is represented by Giacosa and Mazzoleni (2016), in which a model classifies the companies into six groups according to different elements, such as attitude to repay financial debts, company's growth, and profitability. The sample is composed of 39.400 Italian companies. In particular, companies could be divided in these categories: i) star companies; ii) companies at the beginning of decline; and iii) companies in crisis.

It emerged that, in a medium-term vision, it's necessary to change the management behavior and to try to reach economic fundamentals expected by the bank system, while in the short-term vision the companies have to learn how to use a non-bank financial instruments.

Keywords: funding resources, mini-bonds, alternative financial instruments, small and medium companies, Italian context

1. Introduction

The financial structure choices are influenced by both objective and subjective decision-making elements (Giacosa, 2012a and 2012b). Objective elements are linked to the company's needs, as long-term investments must be covered by stable financial sources (for instance, equity or medium-long-term debt), and working capital investments have to be covered by short-term funding sources. On the contrary, the subjective element is linked to the providers of financial resources, which have to be coherent in terms of quantity and costs of enterprises' needs.

Limiting the analysis to funding sources different from equity from current shareholders and trade payables, the parties to whom the companies can recourse are represented by the bank or financial entities different from bank. In Italian banking context, the majority of companies is unprepared to face up the limitation of funding sources, unlike German ones (Mazzoleni, 2016). Therefore, Italian companies have to force a cultural change process, both for developing managerial quality and adapting their economic and financial ratios to market requirements.

The purpose of our research is to propose to model which could suggest to Italian small and medium companies the best appropriate funding resources to their economic and financial situation. The motivation of the research is linked to the current scenario, which is characterized by both banking system's disengagement, cultural companies' unpreparedness and their economic and financial unsuitability, along with some legislative actions lagging behind the companies' needs.

Our framework is represented by Giacosa and Mazzoleni (2016), in which a model classifies the companies into six groups according to different elements, such as attitude to repay financial debts, company's growth, and profitability. In addition, the current research is a development of Giacosa, Mazzoleni, & Rossi (2006), in which they proposed suitable funding methods for Italian and German medium-sized companies by considering their attitude to repay financial debts, the company's growth, and profitability.

The paper's originality is linked to the companies' current context characterized by a strong financial crisis along with some difficulties in terms of fundraising. Therefore, a model permitting both to understand the company's

situation and to identify the appropriate funding method should be interested for sustaining its growth and survival.

The paper's structure is the following. The analysis of the literature concerning to financing policy of small and medium-sized companies is focused on the second paragraph, followed by the illustration of the research method. Paragraph four illustrated and discusses the findings, while conclusions, implications and limitations are contained in the last paragraph.

2. Literature Review

Economic and financial aspects (Giunta, 2007; Value, 2001) along with elements concerning company's growth (Canals, 2001; Hart & Mellons, 1970; Goold, 1999; Grandinetti & Nassimbeni, 2007; Potito, 2013) permit to evaluate and understand the company's situations both in short and medium-long term. Several researchers focused on the definition of the company's financial structure, as the topic has an important role in terms of business management point of view. Topics connected with necessity of self-financing, balance between financial independence and suitable agreements with the third parties were always a subject of various publications.

Several interdependent factors impact the company's situation (Ferrero et al., 2006; Giacosa, 2015), although the literature identified some limitations in their statements (Brealey & Myers, 1988; Ingram et al., 2002; Lombardi Stocchetti, 2013). In particular, within the literature review, we considered two research branches according to our research goal (Fellnhofer, 2015; Mahéroul, 2000; Herrera & Minetti, 2007): i) the first branch is focused on the company's financial structure and the most appropriate relation between investments and funding; ii) the second one is related to traditional and alternative funding instruments, which could be most appropriate for the specific company's situation.

In terms of the first branch, the dilemma connected with correct choosing of sources of funding has been discussed in numerous publications (Dallocchio et al., 2011; Galbiati, 1999; La Rocca, 2007; Venanzi, 2003; Zazzaro, 2008) as it is considered to be an accelerator of the company's growth and helps to meet its financial requirements (Giacosa & Guelfi, 2003; Giacosa, 2015; Fazzari et al., 1988; Ferri & Messori, 2000; Ferri & Rotondi, 2006; Lang et al., 1996; Machauer & Weber, 2000; Oliveira & Fortunato, 2006). Obtained funding sources should be therefore connected also with appropriate investments (Bertini, 1991; Penrose, 1959).

According to the second branch, a variety of contributions exist, several researchers focused on this topic, especially in terms of different funding instruments' advantages and disadvantages (Venanzi, 1999; Marchi & Quagli, 1991), also in terms of Italian context (Castronuovo, 2008; Dainelli & Giunta, 2010; Meles, 2007; Venanzi, 2003) and referring to SMEs (Giacosa, 2015; Giunta, 2005; Pezzini & Di Cesare, 2003; Unioncamere, 2007). Some part of the present contribution is focused on availability of non-bank funding instruments. As one of such instruments is considered also a listing on a financial market (Anderson & Reeb, 2003; Belkhir Boujelbene et al., 2011; Rossi, 2015), although it is usually considered as less enthusiastic solution for financing the company's activities (Bracci, 2007; Gualandri & Schwizer, 2008; Mulkay & Sassenou, 1995; Osteryoung et al., 1992) seeing that it leads to reduce the control over the company (Gallucci et al., 2012).

As literature has not deepened the problem on non-bank funding instruments for Italian small and medium-sized companies, current research tries to fulfil this gap and it has these scientific contributions: i) the introduction of some alternative non-bank funding instruments permits the company's growth, also impacting on corporate culture and business management; ii) sometimes, the recourse of innovative and alternative funding instruments facilitates the company to reach its expectations. Researchers didn't focus on the evolution of the SMEs' conditions in terms of profitability, growth and financial debt repayment. Therefore, our research encourages companies to improve their economic and financial situation, also thanks to the implications of our paper.

3. Methodology

3.1 The Sample

The sample is composed of 39.400 Italian companies. In particular, companies could be divided in these categories: i) star companies; ii) companies at the beginning of decline; and iii) companies in crisis. Star companies of the sample are illustrated in the following table, in terms of clusters of sales revenues and number of companies. Each cluster presents the following ratios: EBITDA, CAGR production value, debt/equity ratio, and relationship between financial debt and EBITDA (Table 1).

Table 1. The star companies in 2015

Sales revenues cluster	Companies nr	EBITDA	CAGR Production value	Debt/Equity	Fin. debt/EBITDA
5-10M ln	2 963	1 143	15,64%	1,25	0,99
10-50M ln	3 216	3 359	16,37%	1,23	1,07
50-100M ln	367	11 225	15,94%	1,28	1,13
100-200M ln	160	22 515	15,73%	1,03	1,04
200M ln-250M ln	25	36 583	13,87%	1,35	1,08
Total	6 731	3 391	16,01%	1,21	1,06

Star companies belong to different economic sectors, with certain average production value (Table 2).

Table 2. Star companies and their belonging to different economic sectors

Sector	Companies		Average production value 2013/2015	
	Nr	%		%
Trade	1 115	16,6%	21 717 483	17,18%
Machinery	1 039	15,4%	22 164 841	17,53%
Engineering	718	10,7%	12 370 066	9,78%
Other manufacturing	479	7,1%	8 504 844	6,73%
Costructions	437	6,5%	7 273 961	5,75%
Rubber -Plastic	390	5,8%	4 347 148	3,44%
Textile	338	5,0%	7 336 173	5,80%
Professional Activities	319	4,7%	7 181 970	5,68%
Alimentaryary	317	4,7%	4 770 054	3,77%
ICT	268	4,0%	4 226 355	3,34%
Transport and storage	235	3,5%	3 981 522	3,15%
Petrol-Chemicals	207	3,1%	5 545 872	4,39%
Automotive	154	2,3%	3 242 357	2,56%
Business services	151	2,2%	2 709 452	2,14%
Accommodation and restoration	137	2,0%	2 193 771	1,74%
Utilities	116	1,7%	1 627 421	1,29%
Pharmaceutical	86	1,3%	4 352 140	3,44%
Real estate	72	1,1%	769 218	0,61%
Agriculture	61	0,9%	1 034 246	0,82%
Financial assets	47	0,7%	526 319	0,42%
Cultural activities	43	0,6%	543 305	0,43%
n.a.	2	0,0%	5 299	0,00%
Total	6 731	100%	126 423 818	100%

Companies at the beginning of decline are described in the table below (Table 3).

Table 3. The companies at the beginning of decline in 2015

Sales revenues cluster	Companies nr	EBITDA	CAGR Production value	Debt/Equity	Fin. debt/EBITDA
5-10M ln	2 453	283	3,78%	3,98	7,15
10-50M ln	2 811	784	4,87%	3,39	7,05
50-100M ln	345	2 578	3,27%	3,10	6,61
100-200M ln	143	5 203	3,49%	2,69	6,51
200M ln-250M ln	20	8 130	4,66%	2,86	6,72
Total	5 772	813	4,18%	3,27	6,88

The companies at the beginning of decline belong to different economic sectors, with certain average production value (Table 4).

Table 4. The companies at the beginning of decline and their belonging to different economic sectors

Sector	Companies		Average production value 2013/2015	
	Nr	%		%
Trade	2 442	42,3%	50 419 070	42,04%
Engineering	416	7,2%	8 617 674	7,19%
Alimentary	408	7,1%	11 695 412	9,75%
Machinery	404	7,0%	8 535 983	7,12%
Costructions	332	5,8%	4 891 739	4,08%
Textile	325	5,6%	6 136 465	5,12%
Other manufacturing	324	5,6%	5 988 246	4,99%
Transport and storage	270	4,7%	5 090 218	4,24%
Rubber -Plastic	238	4,1%	5 010 927	4,18%
Agriculture	117	2,0%	2 541 624	2,12%
Petrol-Chemicals	105	1,8%	2 874 079	2,40%
Professional Activities	87	1,5%	1 643 456	1,37%
Business services	67	1,2%	1 338 275	1,12%
Utilities	64	1,1%	1 375 745	1,15%
ICT	62	1,1%	1 176 345	0,98%
Automotive	43	0,7%	901 546	0,75%
Accommodation and restoration	25	0,4%	479 743	0,40%
Real estate	19	0,3%	319 251	0,27%
Pharmaceutical	13	0,2%	752 972	0,63%
Cultural activities	8	0,1%	118 371	0,10%
Financial assets	3	0,1%	26 665	0,02%
Total	5 772	100%	119 933 806	100%

Companies in crisis are described in the table below (Table 5).

Table 5. The companies in crisis in 2015

Sales revenues cluster	Companies nr	EBITDA	CAGR Production value	Debt/Equity	Fin. debt/EBITDA
5-10Mln	2 495	179	1,39%	4,26	25,98
10-50Mln	2 418	479	2,35%	3,72	19,69
50-100Mln	338	1 357	0,52%	3,70	20,90
100-200Mln	152	2 403	0,90%	4,97	19,90
200Mln-250Mln	33	4 040	5,04%	5,16	14,76
Total	5 436	471	1,74%	4,03	20,77

The companies in crisis belong to different economic sectors, with certain average production value (Table 6).

Table 6. The companies in crisis and their belonging to different economic sectors

Sector	Companies		Average production value 2013/2015	
	Nr	%		%
Trade	1 722	41,67%	42 932 894	43,94%
Alimentary	331	8,01%	9 390 521	9,61%
Costructions	294	7,12%	5 681 233	5,81%
Engineering	249	6,03%	6 942 653	7,11%
Machinery	245	5,93%	4 780 492	4,89%
Textile	181	4,38%	3 065 100	3,14%
Other manufacturing	174	4,21%	3 153 388	3,23%
Transport and storage	171	4,14%	3 179 949	3,25%
Rubber -Plastic	154	3,73%	3 773 848	3,86%
Agriculture	148	3,58%	2 795 499	2,86%
Professional Activities	120	2,90%	3 305 752	3,38%
Petrol-Chemicals	64	1,55%	1 891 543	1,94%
Business services	62	1,50%	1 991 029	2,04%
Real estate	47	1,14%	822 037	0,84%
Automotive	44	1,06%	1 863 625	1,91%
Utilities	42	1,02%	962 692	0,99%
ICT	40	0,97%	607 443	0,62%
Accommodation and restoration	27	0,65%	362 850	0,37%
Financial assets	8	0,19%	110 231	0,11%
Pharmaceutical	4	0,10%	49 486	0,05%
Cultural activities	4	0,10%	44 347	0,05%
n.a.	1	0,02%	4 134	0,00%
Total	4 132	100%	97 710 747	100%

3.2 The Framework

The framework of the paper is represented by Giacosa and Mazzoleni (2016), which proposes a model of companies classification into six groups according to different elements, such as the attitude to repay financial debts, the company's growth, and the profitability. In addition, we said that our research is a development of Giacosa, Mazzoleni & Rossi (2006), which proposed a suitable funding method for medium-sized companies by considering their attitude to repay financial debts, the company's growth, and profitability.

Our framework allows to perform analysis taking into consideration the following elements:

- growth the company's growth is measured thanks to CAGR indicator (Compound Annual Growth Rate), which is calculated as follows:

$$CAGR = \sqrt[m]{PV_m / PV_n} - 1$$

Where:

PV_n, PV_m = value of production in years "n" and "m", where m>n.

- company's profitability:

$$\text{Profitability in the year "n"} = \text{Ebitda (n)} / \text{Production value (n)}$$

- company's attitude to repay financial debt:

$$\text{Attitude to repay financial debt in the year n} = \text{Financial Debts (n)} / \text{Ebitda (n)}$$

The framework uses a matrix, which is divided into 6 quadrants. Each of them contains a bubble which represents a group of companies belonging to the quadrant. The bubble's position is influenced by average profitability and financial debt ratio of companies locating in the same quadrant, while its size represents their average companies' growth. Every quadrant has been matched to the most appropriate financial instruments (Figure 1).

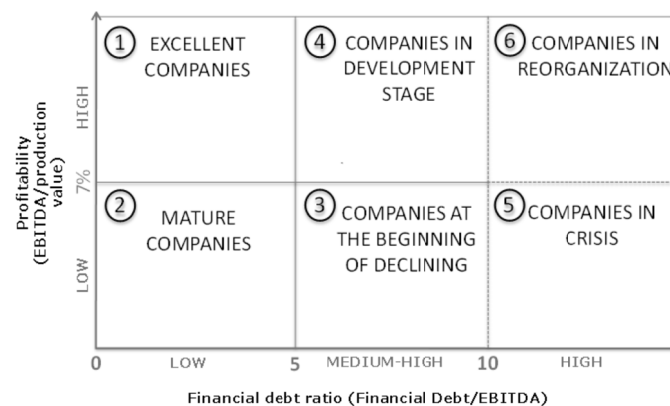


Figure 1. The subjective dimension in financing choices

Subsequently, the companies of our sample have been divided in few categories, according to a credit risk classification model, similar to Moody's, S&P's and Fitch or Cerved. The ratings from AAA to BBB are referred to safe investment (or investment grade), while the ratings from BBB are defined as speculative grade (with high-risk and more profitable investments). Therefore, the following companies' categories have been identified:

1) Investment grade companies, which are composed of the following companies:

i) Star companies and excellent companies – belonging to the first quadrant, characterized by average profitability above 7% and average financial debt below 5. Star companies have access both to bank channel and alternative financial instruments, such as debt (mini-bond or commercial papers) standard or hybrid; quotation on the major or minor markets (AIM); capital market through private equity companies; ii) mature companies – belonging to the second quadrant – which are characterized by a profitability below 7% but they take advantage of a modest financial debt at the level below 5. They often recourse to banking channel and also mini-bonds;

2) High risk companies, which contain the following categories: i) companies at the beginning of decline – belonging to the third quadrant – characterized by a profitability below 7% and a long time of financial debts

repayment between 5 -10 years. They have difficulties in accessing banking channel; therefore, they generally use financial markets (capital and debt); ii) companies in development – belonging to the fourth quadrant – with high average profitability above 7% and an average financial debt between 5-10 years. Generally, the following funding instruments have been used: private equity operators, hybrid debt or equity instruments, and the quotation on the smaller markets; iii) companies in crisis – belonging to the fifth quadrant and characterized by low profitability (less than 7%) and a high financial debt more than 10, and subjected to the bankruptcy procedures. They have serious difficulties in obtaining bank loans; therefore, they need another source of financing in non-bank instruments; iv) companies in reorganization – belonging to the sixth quadrant. They are characterized by high profitability (more than 7%) and financial debt above 10. For that reason, they are also called “distressed companies”. They could use both banking channel and non-bank funding instruments.

4. Findings

It emerged that:

- First two quadrants is composed of 63% of Italian companies characterized by very good attitude in repaying financial debts (they repay their debts at least in 5 years);
- Third and fourth quadrant contain 19,1% of the company with moderate capacity of financial debts repayment (they repay their debts in 5 – 10 years);
- 11,9% of companies has limited attitude of repaying financial debts (in more than 10 years for debt repayment);
- 6% of companies are characterized by negative EBITDA;
- 38% companies have profitability higher than 7%;
- 56% of the companies are characterized by a profitability below 7%.

In addition:

- For star companies, average profitability and capacity to repay financial debts (17,1% of the sample) are little bit better if compared to other companies belonging to the first quadrant (with a growth below of 5%). Their growth in three-year period is high (16,01%), while the growth of other companies belonging to the same quadrant is not lower than the reference parameter (5%) and the results are negative (-2,36%). 32% of Italian companies belonging to the first quadrant can recourse to both standard or hybrid debt instruments (mini bond or commercial papers), along with capital market, private equity operators, or quotation on a main markets or AIM markets;
- The second quadrant (30,09%) is composed of companies with capacity of financial debts repayment in at least 5 years. They are characterized by an average profitability below 7% in three years;
- 14,6% of the companies are “companies at the beginning of decline”: they recorded profitability of 3,65%, low ability to repay financial debts (7.13) and the growth in three-year period of 4.18;
- “Companies in development” are about 4,5% of the sample. They are characterized by high profitability (13,16%) and potential growth (4,07%), and high debt levels (with an attitude of debt prepayment of 6,82);
- An attitude of repaying financial debts in at least 10 years characterizes both “companies in crisis” (10,5% of the sample) and “companies in reorganization” (1,4%). Companies in crisis have an average profitability of 2,09%, a growth of production value of 1,74% and limited attitude of financial debts repayment (17,36 years). Companies in reorganization have an high profitability (24,44%), a certain attitude to repay financial debts (18,42 years) and positive growth (0,69%).

Table 7. The composition of the different quadrants of the matrix

	ITALY	
	Nr imprese	%
Star companies	6.731	17,08%
Excellent companies	5.888	14,94%
Mature companies	12.184	30,92%
Companies at the beginning of decline	5.772	14,65%
Companies in development	1.789	4,54%
Companies in crisis	4.132	10,49%
Companies in reorganization	549	1,39%
Negative Ebitda	2.355	5,98%
Total	39.400	100%

Table 8. Profitability, debt level and growth of companies in 2013-2015

	ITALY		
	PROFITABILITY	DEBT LEVEL	GROWTH
Star companies	14,96%	1,20	16,01%
Excellent companies	14,86%	1,31	-2,36%
Mature companies	3,86%	1,98	5,86%
Companies at the beginning of decline	3,65%	7,13	4,18%
Companies in development	13,16%	6,82	4,07%
Companies in crisis	2,09%	18,42	1,74%
Companies in reorganization	24,44%	17,36	0,69%
Negative Ebitda	-5,54%	(6,68)	-5,06%
Total	7,17%	3,70	4,16%

In addition, companies with better profitability and growth (with the exception of excellent companies) are characterized by an attitude of repaying financial debts in 1 and 2 years. With the exception of companies in development and in reorganization, they record a low profitability and an ability of debt repayment in a long period (more than 6 years).

5. Conclusion, Implications and Limitations

Around 63% of Italian companies can use bank loans without problems, while 37% of the companies the bank loan is not the main source of funding.

In a medium-term vision, it's necessary to change the management behavior and to try to reach economic fundamentals expected by the bank system, while in the short-term vision the companies have to learn how to use a non-bank financial instruments.

Different financing instruments could be used by the company: i) debt financing instruments; and ii) capital financing instruments, or iii) a mixed solution. In making the decision process, the company has to taken into account different aspects, such as the sharing of development project of the company, characterized by potential funders/investors, with the purpose to attract their attention to cover the company's needs. In addition, also the way of evaluating the business projects, which is based on historical results which help to assess the company's creditworthiness (in the case of debt financing instruments), and on a combination between past performance and future results (in the case of capital financing instruments assessment).

The financial market (both considering the capital and debt financing market) is characterized by presents development margins in terms of regulatory framework – which facilitate the use of innovative financing instruments – and the number of actors who may operate. The following considerations emerged:

- Companies characterized by high growth rates and higher profitability pursue a prudent policy in terms of banking channels;
- Innovative funding instruments could encourage the companies to change their environment in terms of using only banking channels;
- Considering a short term vision, a banking channel is the most popular way of obtaining financial sources for small and medium-sized companies. However, in a long term vision, it's emerged a relevant change of this aspect especially considering the financing fixed investments;
- Companies using alternative financing instruments (mini bonds) or the listed one are not always belonging to "excellent companies" quadrant. Therefore, access to alternative financing instruments depends not only on business plan but also on the attitude to introduce it to potential funders.

Theoretical and practical implications of the model are the following:

- In terms of theoretical implications, various solutions for small and medium-sized companies have been proposed to improve their performance. In addition, companies belonging to the third and the fifth quadrant need certain corrective actions to improve their condition;
- In terms of practical implications: useful funding instruments adapted to certain group of companies have been introduced. Undertaking paths proposed by the model can positively impact on the companies' economic and financial position, especially when they are also focused at non-bank sources of financing. In addition, it emerged a need of facilitating an access to alternative financing instruments (such as appropriate legislative government's interventions). Also the introduction of rewards and incentive mechanism for those companies could be considered,

by adopting advanced instruments with the purpose to reduce information asymmetries towards financial community and investors.

The research is characterized by some limitations in different terms:

- According to the analysis, we only used three indicators evaluating the company's economic and financial position (profitability, growth and ability of debt repayment), despite they represent a strong correlation with the company's performance;
- Our model takes into consideration only quantitative variables. Relevant qualitative factors have not been included (such as the originality of the brand, investment projects and market share).

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