EXECUTIVE SUMMARY

The previous edition of the Cerved SME Report (2018) showed that in 2017 the recovery had consolidated, as shown by the significant acceleration of revenues and profitability rates across SMEs, in a framework of marked financial soundness. The data of the new issue of the Report indicate that, in 2018 and in the first part of 2019, ***the recovery has lost momentum in terms of revenues and profit growth****. However, such* ***negative economic trends have not yet affected corporate risk profiles****, which furtherly improved compared to the previous year. In this context, SMEs will need to deal with a brand new reform of bankruptcy regulations (known as "****Code of Business Crisis and Insolvency****"): if implemented successfully, this measure can generate significant benefits for the economic system. The last chapter of the Report focuses on such an issue.*

SMEs covered by the Report

The Cerved SMEs 2019 Report analyses Italian small and medium-sized enterprises (SMEs), identified on the basis of the following classification of the European Commission:

COMPANY CATEGORY	EMPLOYEES		REVENUE		ASSETS
Big-Sized	≥ 250	or	> € 50 m	and	> 43 € m
Medium-Sized	< 250	and	≤ 50 m	or	≤ 43 m
Small-Sized	< 50	and	≤ 10 m	or	≤ 10 m
Micro-Sized	< 10	and	≤ 2 m	or	≤ 2 m

The analysis concerns 157 thousand SMEs that fall under the requirements defined by the European Commission

The analysis concerns all non-financial corporations that fall under the requirements defined by the European Commission in terms of employees, revenues and assets. According to the latest available balance sheets (referring to 2017), **156,754 companies** meet the requirements of SMEs. Out of these, **130,300** are **small enterprises** and **26,454** are **medium-sized companies**. The SMEs under observation employ more than **4 million people**. 2.2 millions of this group of workers are employed in small companies and 1.9 million in medium-sized companies.

Main findings of the Cerved SME Report 2019

The recovery has lost momentum and the profitability of SMEs is declining

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In 2018, the recovery of SMEs, which had lasted since 2013, lost momentum. **Revenues** grew by 4.1% in nominal terms (from 4.4% in the previous year), **but remained broadly at 2017 levels in real terms**. The slowdown covered all sectors **except real estate**, which showed a more sustained growth than the rest of the economy after years of strong weakness.

Value added grew (+4.1%) at a slower pace than labour costs (+5.6%), with negative effects on SMEs' productivity and margins. Recovery of gross profitability has almost stopped: gross margins have increased by 1.2% between 2017 and 2018, compared to 3.2% in the previous year. The gap compared to the pre-crisis period remains broad: SMEs still have levels of **EBITDA 20% lower** than 2007.

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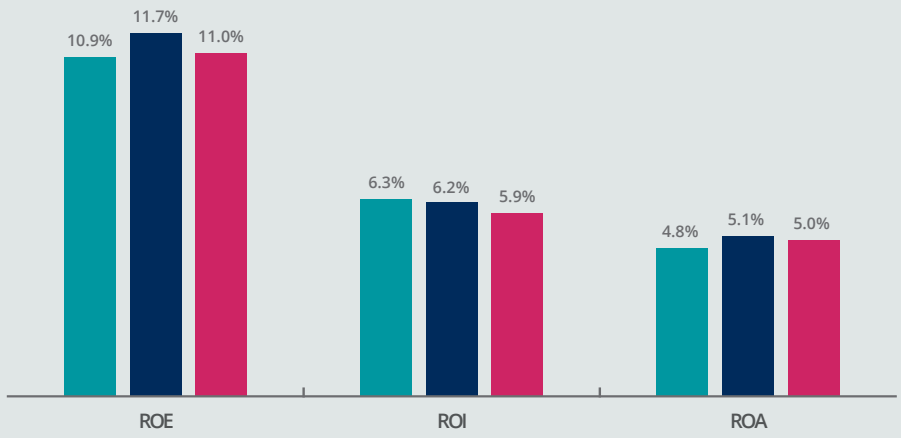
For the first time since 2013, the **profitability ratios of SMEs have been declining**. Current profit before financial charges, operating profitability, ROI, etc. are reduced and – despite a further decrease in the weight of financial charges in the financial statements – the **net profitability decreased from 11.7% in 2017 to 11% in 2018**. The drop in the margins were more relevant for medium-sized enterprises, agricultural companies, and those operating in manufacturing, which, however, maintain indices higher than the ones observed in the rest of the economy.

Data on business demography also indicate **weaker dynamism**, with mixed signals. After a positive jump in 2017 (+5.5%), in 2018 the number of SMEs continued to grow reaching the level of 161 thousand, yet at a **slower pace (+2.9%)**.

Profitability ratios in 2016, 2017 and 2018 among SMEs

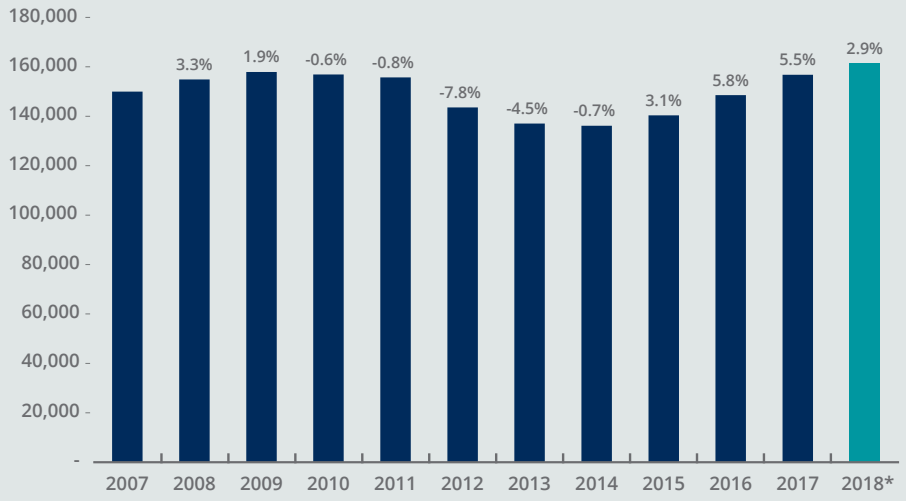


Source:CERVED SMEs Report 2019

Number of SMEs

Number, year on year % changes

** Estimated value*



Source:CERVED SMEs Report 2019

Weakening of demographic dynamics

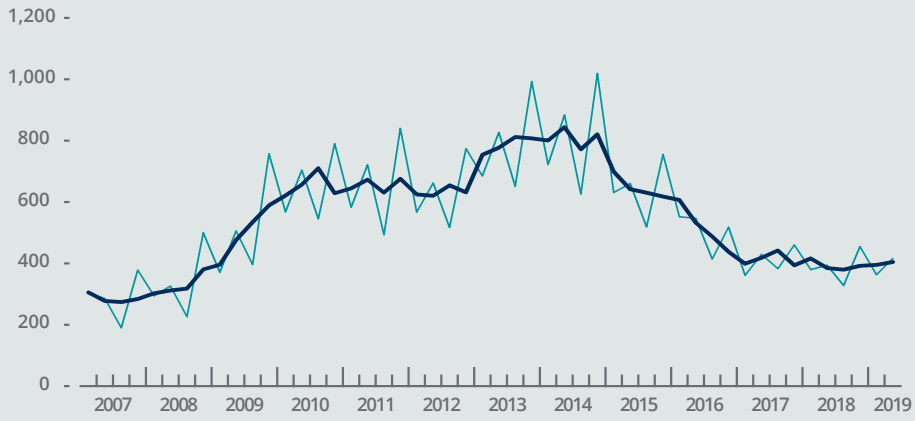
The **positive dynamic of enterprise birth rates** – which played an important role for recovery in the last few years – reached a **peak in 2018**, with an all-time record of new incorporations of companies with shared capital. This has also led to an increase in the number of newcos established on the market, and in their contribution to the economic system, which in any case remains lower than the one observed before the crisis. The increase in enterprise birth rate benefited considerably from the introduction of the so-called "**simplified LTDs**" ("S.r.l. semplificate"), a legal form introduced in 2012 that allows new businesses to be registered at very low cost. This novelty, however, has **exhausted its driving force**: in the first six months of 2019, the number of new companies is falling.

In terms of **bankruptcies**, the marked improvement that characterised the previous years is over: in 2018, the number of SMEs that started default or liquidation procedures **raised again**, with a slight reversal of the trend in 2019. After returning to physiological levels, in 2019 bankruptcies started to increase again, with more sustained increases in the manufacturing and service sectors.

Trends in bankruptcies among SMEs

Number of proceedings

Raw data
Adjusted for seasonality and number of working days



Source:CERVED SMEs Report 2019

Despite challenges posed by the economic situation, SMEs are even more solid with ample room for greater investments

Economic slowdown has not affected the **financial fundamentals of SMEs**, which **have been improving for several years now. Financial debt** grew in 2018 for the second consecutive year, **accelerating** compared to 2017 (+2.2% compared to +1.2%). At the same time, SMEs have **strengthened** their **equity capital** at a much faster pace (+8.5%). This was followed by a further **reduction in the weight of financial debts in relation to equity**, which fell to 63% in 2018 (from 66% in 2017 and 116% in 2007). Despite the slowdown in profitability, the **incidence of financial charges on gross margins reached an all-time low of 13%, thanks also to the ECB's ultra-expansionary policy**.

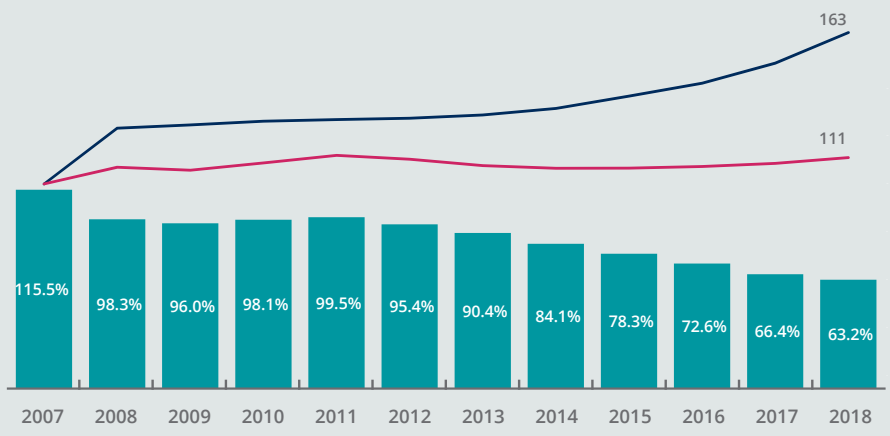
Despite challenges posed by economic situation,in 2018 the strengthening of the economic-financial profile continued after 2017

The scores Cerved assigns to SME balance sheets reflect these structural improvements: the share of SMEs with a 'solid' balance sheet reached a peak in 2017 (56.5%, compared to 39.4% in 2012); that of SMEs with a risky balance sheet reached a minimum of 12.1% (from 22.7% in 2012). This improvement coincided with a period of strong growth in the SMEs base. Data on a large sample of companies that filed their balance sheets in 2018 indicate that the strengthening of the economic-financial profile continued after 2017.

Information on **business payments** shows that, **after a long period of improvement, delays and payment times of SMEs increased in the first six months of 2019**. However, the presence of companies in a very difficult situation – companies that on average pay their suppliers with delays of more than two months – remains low and far from the peaks observed during the recession. Thanks also to a **much more solid capital structure**, the **prospective risk is strongly improving**: the share of SMEs that have had an upgrade of the Cerved Group Score (an evaluation that takes into account all the signs of a company risk of default) between

Trends in financial debts and net capital among SMEs

% financial debts on net capital and index number 2007=100 (financial debts and net capital)



Source:CERVED SMEs Report 2019

September 2019 and September 2018 is at a maximum level and doubles the number of downgrades. After years of polarisation where the distribution of the Cerved Group Score marked a general improvement, but with a slight increase of the risk class, all the distribution is shifted towards the less risky classes.

Investment levels of SMEs remain well below pre-crisis ones, despite their growth in 2018

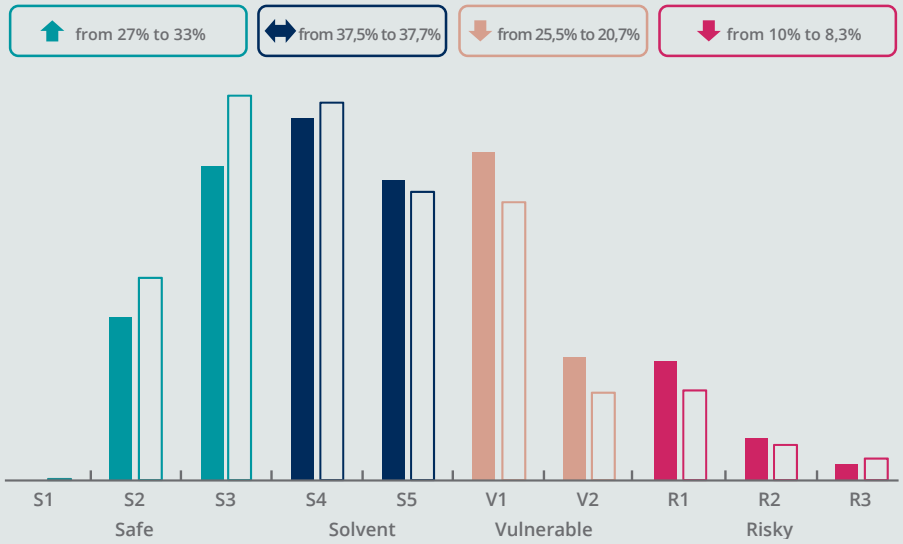
Investments by SMEs grew strongly in 2018: they reached 7.1% of tangible fixed assets, from 6.4% of the previous year. The trend is particularly strong among manufacturing SMEs, which have evidently benefited from the incentives of the **Industry 4.0 National Plan**. Despite these improvements, the investment levels of the SMEs remain well below pre-crisis levels.

Data indicate that the still low absolute levels of SME investment do not depend on financial characteristics, which seem to be adequate to support a greater volume of funding. On the contrary, an analysis of over 100 thousand SMEs, which according to Cerved Group Scoring system are located in the security area or financial solvency, highlights an **enormous untapped potential for financing further investment**. If these "**excellent SMEs**" were to increase their **indebtedness up to twice the EBITDA** – a threshold that the economic literature considers in a safe zone – they could finance investments for **further 133 billion euros**, more than a third of their production capacity.

The most solid SMEs prefer to finance themselves with internal resources or equity

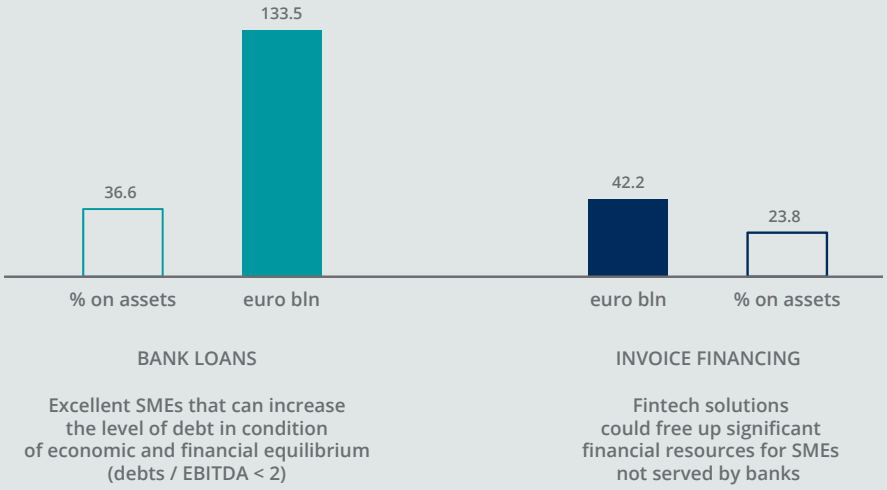
An analysis of the flow of business funds shows that the availability of internal resources for SMEs has grown in a very significant way, which they used to finance investments so far. Compared to the crisis period, stronger SMEs have no difficulties in raising capital, but they often prefer to use internally generated resources or equity capital.

Cerved scoring system in terms of prospective risk for SMEs



Source:CERVED SMEs Report 2019

Untapped potential for investment



Source:CERVED SMEs Report 2019

Fintech solutions could free up significant financial resources for SMEs not served by banks

Another way to increase investment financing could come from **faster payments**, which would reduce the need for SMEs to finance their circulating capital. For example, if time of payments were in line with the average observed in Germany, **resources could be freed up to 181 billion**; if time of payments were in line with that of Spain, up to 133 billion. However, **legislative measures attempting to resolve the problem of late payments have not yet achieved the expected results**. Fintech innovative systems, which allows companies to quickly liquidate their invoices in a very flexible way, can release an important amount of financial resources. In particular, the possibility of choosing which invoices to sell, on the basis of an automatic evaluation based on the risk of the invoice holders, could help SMEs that are in a 'grey' area and cannot get credit from the banks, but address customers with a good degree of financial strength. On this whole, the value of the resources that could be freed is approximately 40 billion euros.

In a context of economic slowdown, the profitability of SMEs could further shrink in the coming years

Uncertainty still dominates the economic situation. **US trade policy** remains among the main concerns about the development of the international economic environment, and have already had serious repercussions on the world economy, in particular in Germany. The Italian economy, one of the most fragile economies of Europe, has suffered the **slowdown of the German economy**, because of the strong linkages in sub-contracting chains.

Expected slowdown of SMEs revenues in 2019

The Italian economy is expected to grow weakly, below the level of one percentage point in real terms over the next three years. These dynamics are reflected on the outlook for SMEs: according to the forecasts, revenues will mark a sharp slowdown in 2019, and accelerate slightly in the next two years.

Forecasts on SME financial indicators in 2019, 2020 and 2021

	2018	2019	2020	2021
Revenue: year on year % changes	4.1%	2.6%	2.9%	3.0%
Value added: year on year % changes	4.1%	2.5%	2.8%	2.8%
EBITDA: year on year % changes	1.2%	0.5%	0.9%	1.5%
Financial debts/ Net capital	63.2%	62.5%	61.9%	61.6%
Financial charges / EBITDA	13.0%	11.9%	11.7%	11.5%
ROA	5.0%	4.7%	4.5%	4.6%
ROE	11.0%	10.5%	10.2%	10.4%
Financial debts/ EBITDA	3.1	3.3	3.2	3.1

Source:CERVED SMEs Report 2019

Gross margins will be substantially stable during 2019 and then growing at a slow pace. Profitability ratios will decline further: in 2021, at the end of the forecast period, the ROE will be at 10.4% (from 11% in 2018).

The decline in risk should continue, albeit at a slower pace than in the past

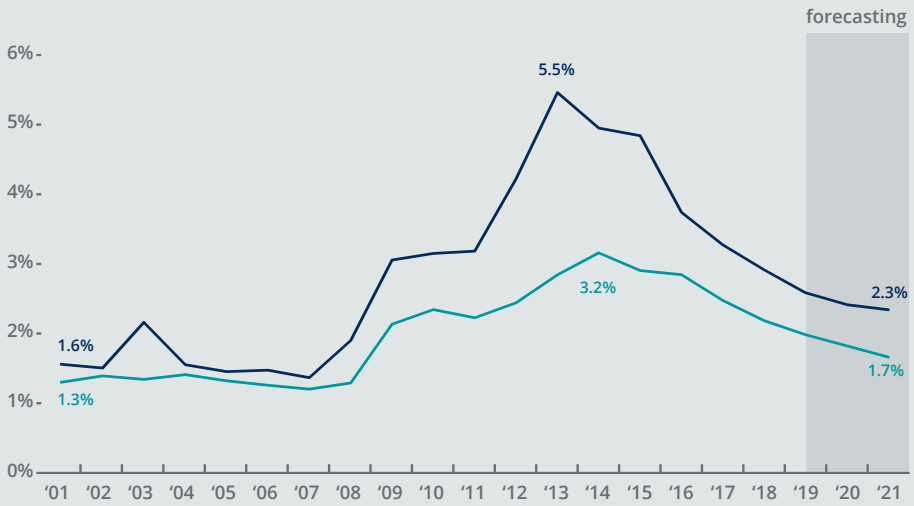
Despite this scenario, the resilience of our SME system will characterize as well the next few years: the **strengthening of capital** and the **decline in risk** should continue, although at a slower pace than in the past. The ratio of financial debt to equity is expected to be 61.6% at the end of the period (63.2% in 2018), the ratio of financial debt to and MOL should stay at its current level.

SMEs will therefore continue to **play with a "defensive" attitude**: they will grow very slowly but will continue to show solid profiles. This will lead to a further reduction in the entry rates to non-performing status across SMEs, which are expected to reach 1.7% in 2021, down five tenths from 2018 levels.

Forecasts in non-performing rates among SMEs

Numbers and value of adjusted bad loans, as % of total outstanding

Numbers
Amount



Source:CERVED SMEs Report 2019

The impacts of alert systems on SMEs

A new bankruptcy regulations package will be fully operational as of August next year. After more than seventy years, it reformed bankruptcy legislation in a comprehensive manner and introduced alert procedures to facilitate the **early detection of crisis situations**. The aim is to encourage the recovery of companies that are in a temporary crisis situation and to make the exit from the market of companies that are in an irreversible crisis situation faster and cheaper.

Alert procedures are based on two pillars: alert tools and organisational obligations

Alert procedures are based on two pillars: **alert tools**, which should help early detection of cases of crisis, and **organisational obligations**, according to which companies must equip themselves with 'organisational structures adequate for early detection of the crisis'. The new rules entrusted the **National Council of Certified Public Accountants and Accounting Experts** (CNDCEC), which has chosen **Cerved as its scientific partner**, with the elaboration of precise indices that make it reasonable to assume a company's state of crisis. Among the proposed indices, particularly important is the DSCR (**debt service coverage ratio**), which is based on an assessment of the adequacy of cash flows to meet the financial needs of the company in the following 6/12 months. The calculation of this index may require the installation of treasury systems software currently used by a limited number of large companies in Italy.

Fulfilment of organisational obligations will require significant investments from Italian companies

Compliance with the provisions of the new Crisis Code, in particular compliance with organisational obligations, will require major investments by the Italian business system: investments to equip themselves with **ERM** (enterprise risk management) systems of monitoring of one's own risk of default, to acquire the skills of risk management, to appoint and remunerate the audit/control bodies etc.

According to estimates based on the expectations of a panel of professionals interviewed by Cerved, these costs amount to about **3.8 billion euros per year** (2.2 billion borne by SMEs). In the event of widespread use of treasury systems, i.e. with the ability of all capital companies to calculate the DSCR, the costs could increase to EUR 6 billion (EUR 2.5 billion borne by SMEs and EUR 2.5 billion borne by micro-enterprises). For a small company, the costs would be about 15-20 **thousand euros** per year; for a medium firm, the costs would double.

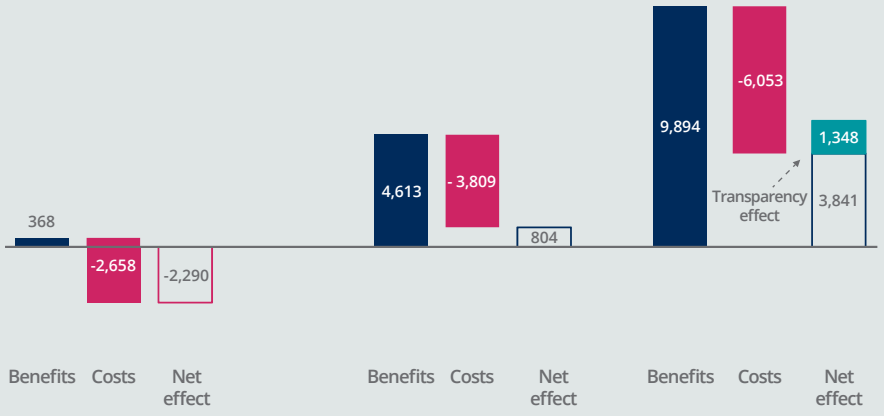
Forecast on costs incurred by companies to deal with reform of bankruptcy regulations

		OBLIGATION TO APPOINT AUDITS			
	Micro firms (no audits)	Small firms (20-50 employees)	Medium firms (50-250 employees)	Big firms (> 250 employees)	Total
Costs for the economic system (euro bln)					
Management and risk control systems	608	570	464	390	2,032
Staff training	127	125	92	119	463
Governance	-	440	484	390	1,314
Total	**735**	**1,135**	**1,039**	**900**	**3,809**
Costs for the firm					
Management and risk control systems	1,106	6,917	15,892	53,917	
Staff training	603	2,800	5,533	27,500	
Governance	-	5,341	16,553	54,002	
Total	**1,709**	**15,057**	**37,978**	**135,418**	

Fonte: Rapporto Cerved PMI 2019

Estimate of potential systemic benefits arising from reform of bankruptcy regulations

Value added, Euro bln



Source:CERVED SMEs Report 2019

Alert systems could generate substantial benefits for the system

On the other hand, procedures for emergence and effective management of the state of crisis can generate substantial benefits for the economic system. In some cases, by supporting companies in overcoming a phase of financial difficulty in order to restructure and return to profitability; in others, by preserving the value of the assets of the companies for which the crisis is irreversible, through faster and effective procedures.

Through a *what if* analysis, these benefits have been quantified. Estimates should be handled with caution, also because of the uncertainty about the concrete application of the new rules. However, some conclusions can be drawn. The success of the reform will crucially depend on how well it is received and how well it is implemented by entrepreneurs and professionals involved. In particular, on the one hand it will be important to spread treasury systems widely, enabling early identification of difficult situations, and, on the other, effective and efficient crisis management by the bodies responsible for the resolution of corporate crises.

If the system addresses the reform in a logic of mere compliance, relying exclusively on budgetary indices without adapting existing organizational models, the costs will far outweigh the benefits: the reform will be reduced to an increase in accounting and organizational requirements, and in the related costs, with very limited benefits in terms of recovery and crisis management.

With widespread adoption of ERM systems, benefits far outweigh costs

On the other hand, in a scenario of timely application of organisational obligations, with ERM and treasury systems spread across all enterprises and procedures of effective crisis composition by the bodies responsible for the resolution of corporate crises , benefits would be largely exceeding the costs (9.9 billion against 6 billion), thanks to the capacity of the of the system to "save" many companies from default and to allow higher rates of asset recovery in companies still destined to exit the market.

The benefits of widespread adoption of ERM systems would not only be limited to the ability to detect crises at an early stage: these systems ensure important advantages for companies, allowing them to orientate their choices regarding investments and financing policies.

These instruments can make small businesses – to which banks now charge interest rates that are unrelated to their risk of default – more transparent: an increase of more than one billion in loans to small and 'solid' micro companies, which would pay less for money, is expected, with a net effect on the value added of a further 1.3 billion.

The Code of Business Crisis and Insolvency provides an opportunity to digitise SME management practices

In other words, the crisis code offers an opportunity to formalize and digitise the management practices of SMEs and to improve their financial culture: a qualitative leap forward which, to date, the business system does not seem to be able to do on its own.
Various players can accompany SMEs on this journey. An important role can be played by the banking system, which could integrate the evaluation tools adopted by the firms to comply with the reform in their early warning systems. The availability of significant flows of already digitised information from electronic invoicing or the current account movements thanks to PSD2 could reduce the costs of data acquisition and ease this transition.