The Mini-Bond Market in Italy

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Credit Crunch in Italy

The Italian economy was severely affected by the deepest recession since the Second World War. Amid a fiscal consolidation programme to reduce the country’s debt, Italy continues its quest to rekindle GDP growth.

Italy’s efforts to boost economic growth are hindered by the sharp decrease in commercial bank lending resulting from the recession. Basel Accord capital adequacy requirements have exacerbated the commercial credit squeeze by forcing Italian banks to cease lending to companies with weak credit ratings. A recent survey by the Banca d’Italia reports a substantial decrease in bank lending across Italian industry, demonstrating that the credit crunch is affecting even well performing enterprises with strong credit ratings.

As shown in the exhibit below, bank lending to non-financial corporations in Italy continues to fall despite the resumption of economic growth and steady progress on the fiscal consolidation programme. According to the European Central Bank (ECB), bank lending to Italian companies in November 2013 dropped by an annual rate of 5.9 percent, the steepest decline since the ECB began collecting such data ten years ago.

Emergence of Mini-Bond Market

Facing persistent restraints on commercial bank lending, a growing number of Italian companies are utilising bonds as an alternative source of financing. Heretofore in Italy, use of bonds was limited to large multinational corporations with direct access to capital markets. Italian small and middle enterprises (which comprise an unusually large share of the country’s GDP) have traditionally relied on bank credit.

To broaden SME access to capital markets, the government of Mario Monti enacted reforms of laws governing financial bills and bonds. The government introduced new regulations that enable unlisted companies to issue debt instruments, commonly known as “mini-bonds”. These regulations expand opportunities for non-bank financing of SMEs by authorising sponsors to support bond issues, enlarging participation in subordinate bonds, and exempting bond investors from taxation on interest earned.

Use of Mini-Bonds by SMEs

While the Monti government’s bond market reforms have stimulated capital flows in Italy, they have not yet generated a significant impact on SME
financing. Less than a year after the introduction of the new regulations, Italian companies have undertaken no more than 20 bond issues valued at just under €5 billion. Large companies account for nearly all of these issues.

The limited use of new bond instruments by Italian SMEs is not the result of a lack of companies qualified to issue bonds. The recession eliminated many small and medium enterprises companies seen as risky or vulnerable. Following the financial crisis, surviving SMEs strengthened their balance sheets in order to stay in business. As a consequence, Italy’s SME sector now includes fewer but stronger companies than existed in 2007.

According to surveys, there are about 35,000 Italian companies with an annual turnover between €5 and €250 million that are considered qualified to issue mini-bonds. These healthy companies (most of which situated in the northern part of the country) generate total annual revenue of €785 billion, produce €162 billion in value added (representing 10 percent of GDP), and owe a combined €140 billion to banks. Such companies offer substantial untapped potential for growth of Italy’s mini-bond market.

A recent success story comes from Caar SpA (Centro Agro Alimentare Riminese), a specialised supplier to the automotive and aerospace industries that issued a €3 million bond in June 2013. This €5 million company intends to use the proceeds of the bond-year bond (which pays 6.5 percent annual interest) to finance its expansion into international markets. Caar is one of ten SMEs that have issued bonds on ExtraMotPro, a new facility on the Italian Stock Exchange in Milan that enables investors to trade bonds issued by unlisted private companies.

Although mini bonds are struggling to attract the attention of Italy’s investor community, a few funds have been created to promote SME bond financing. For example, the bank Monte dei Paschi di Siena has launched a mini-bond fund in partnership with Finanziaria Internazionale Investment SGR (FinInt) and Confindustria. This fund will have a maximum duration of seven years and will raise between €100 and €150 million to support investments in senior unsecured titles with expiries up to five years.

Similarly, Mediobanca launched a mini-bond fund that will be run by Duemme SGR, an asset-management arm of Banca Esperia. This development is significant insofar as Mediobanca has historically served as one of Italy’s leading capital market banks, offering long-and medium-term financing to the country’s largest companies in the postwar era. Other Italian banks such as Intesa and Unicredit are also developing mini-bond facilities to expand the financing options of credit-starved small and medium enterprises.

**Conclusion**

The Banca d’Italia estimates that the country will require €90 billion of additional financing of business investments in the next five years. Amid continuing limits on commercial bank lending, Italy’s nascent mini-bond market offers an important alternative source of financing for small and medium enterprises seeking growth capital.
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