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Financing working capital through financial instruments

Working capital needs in Italy during the Covid-19 emergency, opportunities offered by new European Regulations, and initiatives in Sardinia Region

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t33 Srl - www.t33.it
via Calatafimi 1, 60121 Ancona (Italia)
Tel.+39 071 9715460 - Fax +39 0719715461
E-mail: info@t33.it

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Introduction

The COVID -19 emergency is creating heavy pressure on liquidity for Italian companies. The first estimates for the whole of 2020 vary from €30 billion in working capital requirements to a peak of €138 billion in the most pessimistic scenario depending on the forecasts by the end of the emergency, which still difficult to determine. These estimates are detailed below and are based on Italian enterprises cash flows. They take into account lower turnover due to lower production and sales of products and services, as well as credit and debt flows with suppliers and the respective time delays.

Uncertainty about the duration of the emergency creates significant estimation problems with major effects on the choices - and dimensions - of intervention to stem the crisis. Additional factors also impact on liquidity of Italian entrepreneurs and companies. These include the trends for demand, debt and payment delays from public administrations as well as the availability of credit from financial institutions. All this could seriously limit the effectiveness of support for numerous companies already in obvious difficulty. It could also transform a liquidity problem into a high risk of insolvency, triggering a vicious circle that could quickly lead the Italian economic system from an emergency crisis to a long period of recession, as experienced only a few years ago. A concatenation of causes and effects inevitably fed by the possibility of a significant contraction in enterprises investments as an immediate response to reduced liquidity. This would impact to an uncertain degree on the ability to create, even if not maintain, employment and growth.

However, opportunities provided by the new EU Regulations make it possible to finance working capital through financial instruments and can offer an important *policy* lever. This would complement current (and future) Italian government interventions, available above all for Regions on the front lines to support the needs of their territories through European Structural and Investment Funds (ESIF). Notably, the new European regulatory framework also introduces the possibility of using non-repayable grants to finance working capital. This, which does not foresee repayment of the support, could be particularly suitable to compensate for liquidity losses. But non-repayable financing does not entail many of the advantages offered by financial instruments. A repayment of resources implies the ability to reuse them several times for other measures to support more beneficiaries. This is particularly important in times of scarce public resources. Financial instruments can also encourage financial intermediaries to add their own resources to public ones (leverage), increasing the funds available to businesses. Furthermore, with guarantees for example, financial intermediaries can supply loans to entrepreneurs who cannot offer guarantees of their own and who could not be supported without the public and private sectors sharing the risk. A combination of non-repayable support with financial instruments is also an option for regional managing authorities.

This document illustrates initial estimates of the liquidity needs for Italian companies facing the Covid-19 emergency. It then details improvements for financing working capital introduced by the new EU Regulations. It also describes experiences of Sardinia Region in Italy that is already exploiting the new opportunities offered by these Regulations.

Working capital needs in Italy following the Covid-19 emergency: first estimates

ESTIMATES OF THE CRIBIS - WORKINVOICE OBSERVATORY

A lack of intermediate goods and the closure of factories and offices have interrupted production, leading to a drastic drop in turnover and a consequent worrying shortage of working capital in the Italian business system. As orders and purchases of products and services are cancelled due to the decrease in demand, Italian companies are facing an alarming reduction in liquidity to cover loan repayments, rent, tax, salaries and other expenses. Furthermore, where production continues there are payment delays, especially payments to suppliers, particularly affecting micro and SMEs which are the engine of the national economy. All this could lead to a widespread solvency crisis in production involving, through the supply chains, even companies with balance sheets that were solid before the start of the emergency.

According to a March 2020 Confindustria report[1], the scenario would worsen if less internal corporate liquidity is accompanied by reduced loans from banks, as happened in 2008-2009 and 2012-2013 when the entire Italian economy entered recession. This could transform a liquidity problem into a sustainability risk very quickly where a significant part of current credit, even for solid companies, deteriorates for banks (technically *non-performing loans*). As a potential consequence, this could also worsen the balance sheets of Italian banks, which made considerable and successful efforts to clean up impaired loans in recent years. This would further slow the supply of credit to companies, meaning financial institutions become more averse to taking on new risk which would trigger, as seen just a few years ago, a vicious cycle of *credit crunch* and recession.

Based on initial estimates made in the second half of March 2020 on a sample of 84,000 SMEs[2] by the CRIBIS - Workinvoice Observatory[3], the working capital requirement in the following three months for Italian companies would be between €13 and 25 billion (depending on three hypothetical scenarios) or between €15 and 30 billion if micro enterprises (turnover under €2 million euros) are included. The most likely scenario according to the study[4], even if somewhat optimistic, is a worsening of the payments chain due to longer collection times for receivables and payments to suppliers with a 5% reduction in annual turnover due to production halting for a few weeks. In this case, trade receivables would increase by about €29.7 billion (equal to 16% of outstanding credit) and commercial debts to €16.7 billion (11%) with an overall impact of €13 billion on net working capital before summer. The study also underlines that none of the scenarios hypothesized additional working capital through stock reductions. This would be effective for a few weeks, but not capable of eliminating the problem of managing the new working capital requirements, only postponing the challenges.

[1] Centro Studi Confindustria (2020), *Le previsioni per l'Italia. Quali condizioni per la tenuta e il rilancio dell'economia?*, Spring 2020, report with data and information at 27 March 2020. The General Confederation of Italian Industry (Italian: *Confederazione generale dell'industria italiana*), commonly known as Confindustria, is the Italian employers' federation and national chamber of commerce, founded in 1910. It groups together more than 113,000 voluntary member companies, accounting for nearly 4,200,000 individuals.

[2] The estimate is based on a sample of approximately 84,000 SMEs with a turnover of between 2 and 50 million euros, drawing on the complete 2018 balance sheet data, calculating the possible lengthening of collection and payment times due to the economic repercussions of the Covid-19 emergency.

[3] https://www.workinvoice.it/pmi-attenzione-circolante-effetti-della-crisi-da-coronavirus-sono-importanti-e-vanno-gestiti-per-tempo/

[4] This is the second scenario. In the first scenario, the pandemic would have a soft impact on the economy, turnover would be unscathed, but the collection times for credits would increase by 20-days, which in turn would delay payments to suppliers by 10 days. All other factors being equal, this worsening of payments would translate into increased loans to customers of around €41 billion (22% of the outstanding amount) and commercial debts of €13.9 billion (+ 9%) with an impact on the working capital requirement of €27 billion (+16%). The third scenario, the worst, assumes a 20% drop in annual turnover with collection and payment times for suppliers expanding by 30 and 15 days respectively. In this situation, commercial debts would increase by approximately €10.6 billion (6% of the outstanding amount) and working capital, net of the temporary reduction in inventories, would be €14.7 billion (9%).

On the same sample of companies, the analysis of CRIF Ratings[5] also reveals that slightly more than half (about 55%), with minimum or zero levels of debt or with available cash equal to or greater than debts due in the next 12 months, would be able to meet working capital liquidity needs. But about 37% of the sample is represented by SMEs that start from already delicate liquidity situations, while the remaining 7% have limited room for manoeuvre. Therefore, during 2020, liquidity needs will be around €60 billion, of which only some €15 billion, will be covered by cash flows generated during 2020.

Starting from an optimistic scenario, i.e. assuming that the current emergency does not impact the Italian and international economy in the last part of 2020 let alone 2021, the financial needs for the whole of 2020, including reimbursements of maturing financial debt and investments, could reach up to €45 billion[6]. Of these, almost half would involve SMEs in the regions most affected by the health emergency, namely Lombardy, Veneto and Emilia-Romagna. These regions have a high concentration of companies and production chains as well as significant internationalization. The sectors most affected would be wholesale, manufacturing (especially metallic and non-metallic products) textile and clothing. To these must be added tourism and leisure which, despite generally having greater liquidity, remains one of the hardest hit by the crisis and will therefore need additional support.

As a direct response to these liquidity needs, companies and in particular those in capital-intensive sectors, could reduce investments in the short term. However, reducing investments - already stagnant in the previous year - would impede growth and employment and may not fully cover the liquidity needs estimated above.

CENTRO STUDI CONFINDUSTRIA ESTIMATE

The forecasts above must also be read in the light of broader possible consequences of the Covid-19 emergency on the Italian economy. These could further amplify the liquidity needs in an unpredictable way and undermine the response capacity and recovery of SMEs. Assuming that the emergency ends in May 2020 and production gradually resumes before summer, the Centro Studi Confindustria[7] estimated a 10% drop in Italian GDP in the first two quarters compared to the end of 2019, followed by a partial recovery in the second half of the year. On average a drop in Italian GDP of 6% in 2020 is expected[8]. If the health situation does not improve, the economic forecasts should be revised downwards. According to current parameters, every extra week that production activities are blocked would lead to a further loss of GDP of at least 0.75%. The recent DEF[9], for example, has already revised these initial estimates downwards, with a GDP decline of 8% in 2020[10].

Table 1: The effects of Covid-19 on Italian GDP and industrial production (2020, by quarter)

	GDP		Industrial production	
	%	€ billion	%	€ billion
Q1	-3,5	-15,0	-5,4	-13,0
Q2	-6,5	-27,0	-15,2	-35,0
Q3	4,0	16,0	7,5	15,0
Q4	2,5	10,0	4,0	8,0

Source: S. Manzocchi (2020), Presentazione del Rapporto del Centro Studi Confindustria 'Le previsioni per l'Italia. Quali condizioni per la tenuta ed il rilancio dell'economia?, 31 March 2020

In this scenario, industrial production suffers most (-€25 billion for 2020)[11]. In addition, corporate investment - confirming what was highlighted above in the CRIF Ratings analysis - will be the most affected component of

[5] https://www.crif.it/area-stampa/comunicati-stampa/2020/marzo/emergenza-coronavirus-alle-imprese-servono-15-miliardi-euro-di-liquidit%C3%A0-nei-prossimi-3-mesi/

[6] Calculation of the total requirement was made on an aggregate turnover of €716 billion, of which receivables from customers account for 19% of total assets (€190 billion).

[7] Centro Studi Confindustria (2020), *Le previsioni per l'Italia. Quali condizioni per la tenuta e il rilancio dell'economia?*, Spring 2020, report with data and information as at 27 March 2020.

[8] According to Confindustria, these estimates are in line with the Munich IFO which further revises GDP downwards, given that a partial closure of economic activity in Italy lasting two months could reduce growth in 2020 by 8.0 to 13.1%, depending on the scenario.

[9] The economic and financial document used by the Italian Government to present all economic and financial decisions and measures.

[10] https://www.ilsole24ore.com/art/def-stop-clausole-salvaguardia-iva-2021-ADflpAM

[11] According to the most recent estimates at the beginning of May 2020, the fall in Italian industrial production would be over 50% in March and April, or 26.1% in April over March, when it fell by 25.4% over February. A fall of such magnitude has no historical precedent. This dynamic is explained by two factors: the blockade of industrial activity, decided on 22 March, which affected almost 60% of

GDP in 2020 (-10.6%). Italy's exports are not spared by the decline in economic activity (-5.1% expected in 2020).

Furthermore, household consumption in the first half of 2020 was affected by the inability to make purchases following the *lockdown*, excluding food and pharmaceutical products, leading to a reduction in private spending of 6.8% compared to last year. There will be a substantial recomposition of the basket, especially reducing clothing, transport, services, recreation and culture, accommodation services and catering. Private consumption could then further decrease following increased unemployment.

Table 2: Centro Studi Confindustria forecast for Italy (%)

	2018	2019	2020	2021
GDP	0,8	0,3	-6,0	3,5
Private consumption	0,9	0,4	-6,8	3,5
Gross fixed capital formation	3,1	1,4	-10,6	5,1
Exports	2,3	1,2	-5,1	3,6
Imports	3,4	-0,4	-6,8	3,9
Employment (ALU)	0,8	0,3	-2,5	2,1
Unemployment rate	10,6	9,9	11,2	9,6
Consumer price	1,2	0,6	0,2	0,6
Debt of public administrations*	2,2	1,6	5,0	3,2
Public debt*	134,8	134,8	147,0	144,3

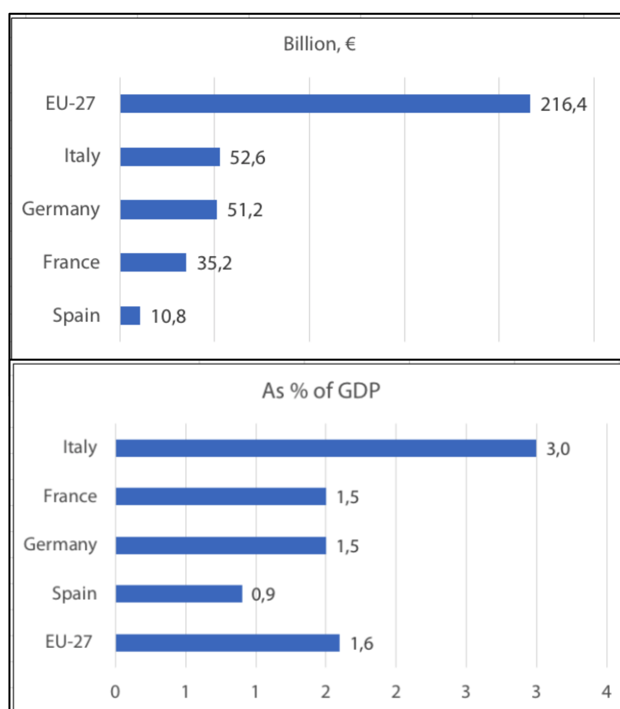
*as % of GDP

Source: Centro Studi Confindustria (2020), Le previsioni per l'Italia. Quali condizioni per la tenuta e il rilancio dell'economia?, Spring 2020, p.55, report with data and information as at 27 March 2020.

Another non-secondary aspect should also be considered. Any existing or planned public intervention will have to deal with an estimated growth in public administration debt to 5.0% of GDP by the end of 2020[12], dropping to 3.2% in the following year. A rise in public debt in 2020 will inevitably require, sooner or later, more State revenue with implications on taxation for both businesses and individuals.

Furthermore for SME liquidity, according to Eurostat, Italian public administrations at the end of 2018 already had €53 billion of payables to suppliers, ranking first among European public administrations. According to the latest Bank of Italy annual report (May 2019)[13], the commercial debts of Italian public administrations decreased from 3.2% of GDP in 2017 to 3.0% in 2018. Bank of Italy estimates that about half this amount is linked to a delay in payments compared to contractual deadlines as the average payment time for public administrations was 54 days in 2018, well above the 30 days (60 for health) set by Directive 2011/7/EU. Furthermore, this data from the Ministry of Economy and Finance, is weighted by invoice amounts and calculated only on invoices paid. So, it does not include unpaid invoices. Consequently, the average time is undoubtedly higher and could significantly increase during this crisis given the well-known inefficiencies of Italian public administrations combined with an increased workload.

Figure 1: Debt of public administrations at 31 December 2018



Suorce: Confindustria (2020), Pagamenti PA ancora lenti - Valutazione delle politiche pubbliche, 22 Aprile 2020. Elaborazioni Centro Studi Confindustria based on Eurostat (October 2019)

manufacturing companies for just over a week in March and throughout April; and very low domestic demand, from closing activities in some service sectors and limitations on the movement of people, combined with a strong decline in foreign demand, especially in April, when restrictive measures were introduced in Italian trade partners. Source: Centro Studi Confindustria (2020), *Indagine Rapida CSC sulla Produzione Industriale,* Congiuntura e Previsioni, 4th May 2020.

[12] The recent DEF estimates an increase in public debt to 155.7% and in the deficit to 10.4%.

[13] Banca d'Italia (2019), *Relazione annual - Anno 2018,* 31st May 2019.

The same study by Confindustria shows that in this scenario the crisis could worsen in the immediate future. The situation was already tense for Italian corporate working capital where a gradual erosion of liquidity was noted in the financial statements of the last two years compared to the peak at the end of 2017. It should however be stressed that at the beginning of 2020 liquidity in companies with respect to operational needs was sufficient, well above the lows in 2013.

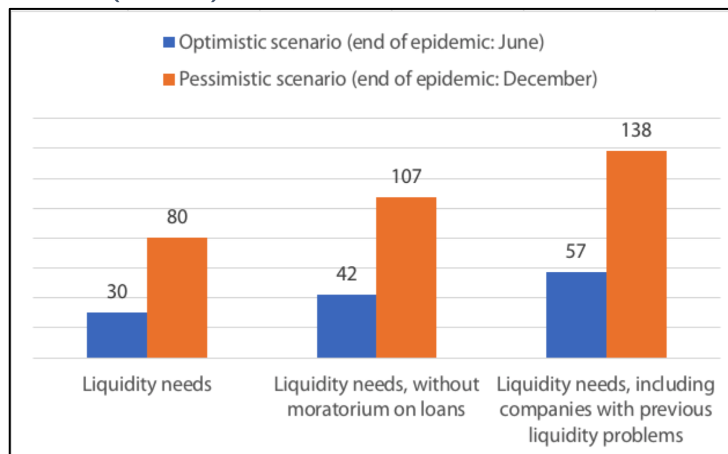
Figure 2: Liquidity trend in companies (manufacturing, with respect to operational needs, balance)

Source: Centro Studi Confindustria (2020), Le previsioni per l'Italia. Quali condizioni per la tenuta e il rilancio dell'economia?, Spring 2020, p.21, report with data and information as at 27 March 2020.

However, even companies with basically solid financial statements (such as the 55% in the CRIF Ratings analysis previously described) could have immediate cash flow difficulties. With an improvement in the medium-term capital and reserves at the end of the year could cover losses from a greater reduction in revenues than costs. But if the problems that drain liquidity persist for only a few months (and not years), many companies can very quickly have liquidity problems, with a risk of freezing their operations.

In April 2020 Confindustria provided an initial estimate of the liquidity needs for 2020[14] on the basis of a large sample of limited company balance sheets (making up one third of GDP and 55% of employment). Assuming the epidemic ends in June (optimistic scenario), 2020 liquidity needs would be €30 billion, with a large part needed before the summer. This would rise to as much as €80 billion in a pessimistic scenario (restrictions ending in December). Furthermore, in the absence of a moratorium on loans (launched in March, for SMEs free from unpaid debts), these estimates would rise to between €42 and 107 billion. Including companies with previous liquidity problems would further increase this to between €57 and 138 billion.

Figure 3: Estimate of the liquidity due to the Covid-19 crisis in Italy for 2020 (billion €)



Source: Centro Studi Confindustria (2020), Fornire liquidità alle imprese per ripartire, Apri 2020. Anlysis by Centro Studi Confindustria based on data from F.Schivardi, lavoce.info.Data at 10 April 2020.

The situation appears more problematic if we look at bank loans to businesses. These decreased in 2019 by 1.9% compared to December 2018, and, after modest growth in 2018, the decline continued, albeit moderately, even to the beginning of 2020 (-1.0%). This negative trend contributes to further curbing already weak economic activity in companies facing liquidity problems caused by the epidemic and occurs just after very difficult years for bank loans. Loans fell in all sectors, less in manufacturing (-0.5%) and more in services (-1.7%) and construction (-4.3%), and especially more for smaller companies than big ones. In addition, by combining qualitative Bank of Italy and ISTAT[15] data on the supply and demand for credit, the analysis by

[14] Centro Studi Confindustria (2020), *Fornire liquidità alle imprese per ripartire*, April 2020. Elaboration by Centro Studi Confindustria based on data by F.Schivardi, lavoce.info.
[15] Italian Institution of Statistics.

Confindustria[16] underlines how the declining trend for loans to businesses is mainly determined by the supply, following the gradual tightening in bank credit criteria[17] between mid-2018 and late 2019.

The credit needs of enterprises between late 2018 and late 2019 remained substantially stable, so credit demand has not suffered any contraction (in line with a stagnation of investments). Requests for fixed investment finance have slightly increased while the share of manufacturing companies that do not obtain loans has fallen, albeit slightly. If, therefore, the demand for bank loans by companies has remained almost constant but the supply is decreasing, in the absence of alternative sources, financing even unchanged levels of activity becomes very difficult and less credit availability becomes an impediment to investment and growth. This drop in loans, "suffered" and not "wanted" to use the terms adopted by Confindustria, adds to the growing liquidity needs of Italian companies. This not only impacts their investment capacity and current employment levels but also continuity of the activity itself.

Figure 4: Business credit trend (loans, annual% variation)

Source: Centro Studi Confindustria (2020), Le previsioni per l'Italia. Quali condizioni per la tenuta e il rilancio dell'economia?, Spring 2020, p.71, report with data and information as at 27 March 2020.

[16] Centro Studi Confindustria (2020), *Le previsioni per l'Italia. Quali condizioni per la tenuta e il rilancio dell'economia?*, Spring 2020, pp.70-71, report with data and information as at 27 March 2020.

[17] The excessive increase in credit criteria is due to several factors: risks for specific sectors and the Italian economy; continuing uncertainty about banking and supervisory rules, which keeps institutions' aversion to credit risk high; low interest margins, given low rates which lower banking profitability, despite lower loan adjustments and some recent cost reductions.

Recent regulatory changes on the use of ESIF financial instruments to finance working capital

MEASURES ADOPTED BY THE EUROPEAN UNION FOR ESIF

Although Italy was one of the first countries in the EU hit hard by the Covid-19, the emergency has rapidly spread throughout the EU, affecting social health and the economy in all Member States. The epidemic has slowed economic growth, causing liquidity problems for companies, especially SMEs that make up 99.8% of all European enterprises - 92.8% of which have less than ten employees, i.e. micro enterprises - and responsible for two-thirds of employment and almost 60% of value added).

The European Commission therefore introduced an investment initiative on 13 March 2020 to face this public health emergency, mobilising €37 billion of public investments in Member States and channelling all available resources from the EU budget towards national governments. This first proposal became an EU Regulation on 30 March 2020[18] thanks to the approval of the European Parliament and the Council. This includes the anticipation of payments, a reorientation of cohesion funds and a reallocation of resources where most needed, declaring expenditures related to Covid-19 eligible under Structural Funds rules.

The Commission proposes to release funds to counter the crisis by rapidly mobilizing liquidity reserves from the ESIF. Thanks to the modification applied to Article 139 of Regulation (EU) 1303/2013, the Commission will not issue a recovery order for pre-financing of €8 billion, which Member States should have repaid by June 2020. These funds were not spent under the European Regional Development Fund (ERDF), European Social Fund (ESF), Cohesion Fund (CF) and European Maritime and Fisheries Fund (EMFF). Given average co-financing rates in Member States, this amount will be combined with an additional €29 billion. This co-financing from the EU budget will allow states to invest resources in fighting the spread of the virus and boost the economy. In addition, Member States can still access €28 billion of structural funds in their national coffers not yet assigned to projects and therefore available for actions to stem the crisis.

The second proposal put forward by the European Commission on 2 April 2020 - Investment Initiative in response to the coronavirus Plus - became an EU Regulation on 23 April 2020[19]. This gives more flexibility to Member States that can transfer financial allocations between cohesion policy funds and between regions. There will also be greater flexibility on thematic concentration. This second Regulation includes the opportunity of a 100% EU co-financing rate for cohesion policy programmes in the fiscal year 2020-2021. This avoids national co-financing, enabling Member States to use their state budgets for other expenditure.

PROPOSED CHANGES IN THE USE OF FINANCIAL INSTRUMENTS TO SUPPORT WORKING CAPITAL FOR SMES

Regulation (EU) 2020/460 of 30 March 2020 amends some articles of Regulations (EU) 1303/2013 (CPR) and 1301/2013 (ERDF) giving important funding opportunities for enterprises in difficulty. The following subparagraph has been added to Article 37(4) of Regulation (EU) 1303/2013: *"In addition, the ERDF may support*

[18] Regulation (EU) 2020/460 of the European Parliament and of the Council of 30 March 2020 amending Regulations (EU) No 1301/2013, (EU) No 1303/2013 and (EU) No 508/2014 as regards specific measures to mobilise investments in the healthcare systems of Member States and in other sectors of their economies in response to the COVID-19 outbreak (Coronavirus Response Investment Initiative), in https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0460&from=EN.

[19] Regulation (EU) 2020/558 of the European Parliament and of the Council of 23 April 2020 amending Regulations (EU) No 1301/2013 and (EU) No 1303/2013 as regards specific measures to provide exceptional flexibility for the use of the European Structural and Investments Funds in response to the COVID-19 outbreak, in https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0558&from=EN.

the financing of working capital in SMEs where necessary as a temporary measure to provide an effective response to a public health crisis."

Firstly, points 35, 36 and 37 in the preamble of Regulation (EU) 1303/2013 should be mentioned. These outline the features of financial instruments supported by ESIF. Point 35 states, they "*should be used to address specific market needs in a cost-effective way, in accordance with the objectives of the programmes, and should not crowd out private financing*", to encourage the participation of private investors and financial institutions. The financial instruments can include (point 37) equity or quasi-equity investments, loans, guarantees and other risk-sharing instruments. Finally, the Regulation specifies that managing authorities should implement these financial instruments in a flexible way, considering reusing "*part of the resources paid back during the eligibility period in order to provide for the preferential remuneration of private investors or public investors operating according to the market economy principle*" (Point 36).

In parallel, we should consider the original Article 37(4), which states that financial instruments used to support businesses including SMEs should be aimed at the "*establishment of new enterprises, early stage-capital, i.e. seed capital and start-up capital, expansion capital, capital for the strengthening of the general activities of an enterprise, or the realisation of new projects, penetration of new markets or new developments by existing enterprises, without prejudice to applicable Union State aid rules, and in accordance with the Fund-specific rules. Such support may include investment in both tangible and intangible assets as well as working capital within the limits of applicable Union State aid rules and with a view to stimulating the private sector as a supplier of funding to enterprises. It may also include the costs of transfer of proprietary rights in enterprises provided that such transfers take place between independent investors*".

It is clear that previously an enterprise could receive support in the form of working capital, but this had to comply with State aid rules, the specific rules of each ESIF, specific criteria imposed by the programme and investment priority and had to aim at achieving an objective mentioned in the article. The company had to present a business plan and related documents that demonstrated its financial soundness and the aim for requesting such support. This type of support could also include, in line with State aid rules, private investment of 10% to 60%.

Thanks to this change, the Commission aims to especially support SMEs incurring huge costs and suffering losses. This financing is not necessarily linked to private co-investments and to achieving one of the objectives mentioned above, but intends to finance costs and / or offset losses related to the Covid-19 emergency. Any element of working capital can be supported, including financing debts for raw materials and other production factors such as labour, taxes, inventories and overheads, rent, utilities, current debts, commercial receivables and non-consumer sales receivables.

Furthermore, in accordance with Article 37(4), we should take into consideration the Commission's communication on State aid measures[20] with a "*limited amount of temporary aid*" intended to support "*companies that find themselves facing a sudden shortage or even unavailability of liquidity*" and that "*can be an appropriate, necessary and targeted solution during the current circumstances*" (point 21). Such State aid is considered compatible with the internal market, provided that the total amount of aid complies with certain conditions. Aid may be in the form of grants, tax and payment facilities or other forms such as repayable advances, guarantees, loans and participations, provided the total nominal value of these measures remains below the €800,000 ceiling[21] per company. The amount must be gross of any tax or other charge. Such aid cannot be granted to companies that were already in difficulty on 31 December 2019. In particular, the State can provide aid as guarantees related to both investment and working capital loans (point 25 (g)), and subsidized interest

[20] Communication from the Commission. Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (2020/C 91 I/01), in https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020XC0320(03)&from=EN. Amendment to the Temporary Framework for State aid measures to support the economy in the current COVID-19 outbreak (2020/C 112 I/01), in https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020XC0404(01)&from=EN.

[21] For fishery and aquaculture businesses aid cannot exceed €120,000, and for primary producers of agricultural products, aid cannot exceed €100,000.p

rates for loans relating to investment and/or working capital (point 27 (f)). Notably, these temporary aid measures can be cumulated with aid that falls within the scope of the *de minimis* regulation.

Article 3 of Regulation (EU) 1301/2013 is also modified. A paragraph has been added to point 1 of the article, which clarifies that the ERDF can also be used to help companies cope with short-term financial shocks related to the health emergency. Therefore, the fund can support working capital for SMEs as a temporary measure. Article 3(3)(d) of the same Regulation is also amended, enabling ERDF to support companies receiving support in accordance with the temporary framework for State aid measures.

Thanks to the investment initiative in response to coronavirus Plus, the Commission aims to further reduce administrative burdens and delays in implementation. Article 25(a) in points 10 and 11 states that for financial instruments providing support to SMEs in the form of working capital, managing authorities and companies would not be required to present a revision and update of the ex-ante evaluation, nor new or updated business plans, equivalent documents or further evidence to verify the support has been used for the specified purposes.

In addition, the Commission proposes to change the use of financial instruments within the EAFRD framework. In the past, working capital support was only possible for agricultural and forestry companies, it could not exceed 30% of eligible expenses and was aimed only at companies that wanted to invest in new businesses. With the second paragraph in Article 25(a) point 11, EAFRD beneficiaries can access loans or guarantees of up to €200,000 on favourable conditions to help them finance costs or compensate for losses, without having to show they are investing in new businesses.

Furthermore, with the Regulation (EU)[22] concerning fisheries and aquaculture, the European Commission opens up the possibility of financing aquaculture farmers through working capital or compensation under the EMFF framework (Articles 55(1)(b) and 69(3)). Those undertakings can access such support if they have temporarily suspended or reduced production and sales, or if they face additional storage costs between 1 February and 31 December 2020, following the epidemic.

It should also be remembered that existing financial instruments and those recently created thanks to the additional ESIF resources can be combined with non-repayable grants to support working capital[23]. This responds to the needs of enterprises following the Covid-19 emergency and is in line with the changes made to Article 3(l) of ERDF.

In line with the flexibility guaranteed by the specific article 3(1) for the ERDF and article 37(7) and (8) of Regulation (EU) 1303/2013, non-refundable grants in support of working capital can be paid through an agreement under which the financial intermediary is the beneficiary of the grant in accordance with article 2(10)(2) of Regulation (EU) 1303/2013, which provides liquidity to final beneficiaries of less than €200,000; or as direct non-refundable grants to final beneficiaries managed by the managing authority or an intermediate body. Only enterprises damaged by the public health emergency can benefit from it and article 3(1) of the (EU) ERDF Regulation amended by EU Regulation 2020/460 must also be respected. It should be noted that this type of non-refundable grant cannot be used to repay any ESIF support received through financial instruments. In addition, expenditure included in the payment application cannot be declared for support received from another Fund or EU instrument, or for support received by the same Fund but under another programme. Expenditure is declared eligible from the date of signature of the contract or from the entry into force of the anti-crisis package created by the financial institution and the financial support must comply with the temporary State aid framework. Finally, managing authorities may also provide grants to finance working capital supporting the portfolios of public/private loans not supported by ESIF and managed by financial institutions, supporting beneficiaries who have already applied or will apply for a loan to these financial institutions[24].

[22] Regulation (EU) 2020/560 of the European Parliament and of the Council of 23 April 2020 amending Regulations (EU) No 508/2014 and (EU) No 1379/2013 as regards specific measures to mitigate the impact of the COVID-19 outbreak in the fishery and aquaculture sector, in https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0560&from=EN.

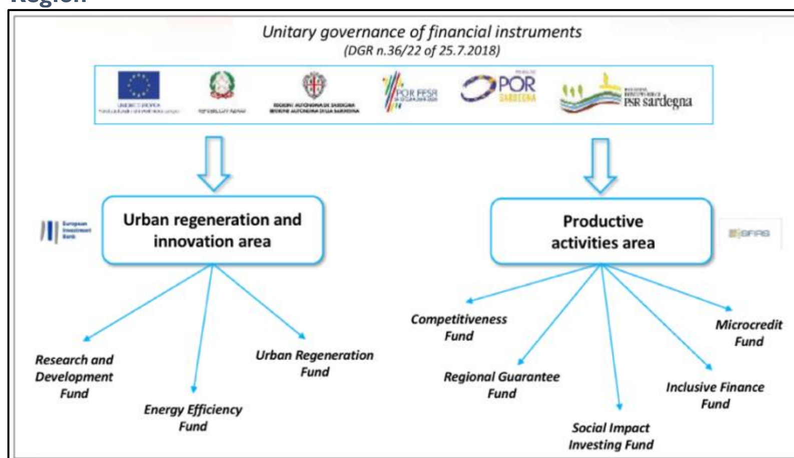
[23] *fi-compass* (2020), *Responding to the COVID-19 crisis through financial instruments in the framework of the Coronavirus Response Investment Initiative* , European Investment Bank, May 2020.

[24] Here too, the beneficiary may be the financial institution which must demonstrate it is using these grants to cancel interest payment obligations of SMEs for loans requested or which are in the process of being requested. The managing authority can also directly select

Possibilities for the Regions: first measures adopted by Sardinia Region

Since the 2007-2013 programming period, Sardinia Region has made extensive use of financial instruments to convey ESIF resources to support enterprises, urban regeneration and energy efficiency. The Regional Guarantee Fund (€233.2 million), the Fund for the Reindustrialisation of Industrial Areas (€50 million) and the Holding Fund JESSICA Sardinia (€81.1 million) dates back to this period with resources of the ERDF Regional Operational Programme 2007-2013. Given the positive results, in the 2014-2020 programming period the Region, in addition to confirming the Funds previously established by reinvesting the resources returned for the same purposes, also implemented new tools and adopted a more effective unitary governance grouping the management of different financial instruments operating under various Funds under a single structure to support the different managing authorities of ERDF, ESF and EAFRD Operational Programmes.

Figure 5: The unitary governance of financial instrument in Sardinia Region



Source: Comitato di Sorveglianza POR FESR 2014-2020 - Strumenti finanziari, Cagliari, 24 July 2019.

This enhanced the effectiveness of existing tools and the response capacity of this unitary governance also enabled the Region to immediately seize the opportunity offered by the new Regulation 2020/460, activating three new lines of intervention.

Within the Regional Guarantee Fund, a specific line for the Covid-19 emergency with an additional budget of up to €50 million will enable bank loans for enterprise working capital by providing an 80% guarantee (extendable to 100% by associating other counter-guarantee instruments). The Region, in agreement with the ABI[25], is also working to simplify administrative procedures to streamline access and use of the tool. Activation of the new interventions should be very quick.

To support businesses through loans, the Region is developing a specific tool in accordance with the European Investment Bank (EIB). The idea is to create a fund of funds with €60 to €100 million, based on both EU and regional resources. This is similar to the existing Agri Platform - where the EIB and eight Italian regions finance new investment portfolios supporting agricultural businesses, by financial intermediaries selected by the EIB itself - and to the Jessica Sardegna Holding Fund.

The new fund will offer short, medium and long-term financing dedicated to:

- *working capital*, through loans to support management and operating expenses, generated by liquidity needs, to allow payments to employees and suppliers, safety of the workplace, and other interventions that are indispensable to restart activities;

- *investments*, as loans supporting and strengthening production in enterprises directly engaged in combatting Covid-19, or in strategic supply chains where it is essential to maintain productive capacity on a regional scale.

SME beneficiaries to allow them, for example, to pay interest on their loans, or use a fund of funds that becomes the beneficiary owner of grants which will then be paid to enterprises.

25 Italian National Association of Banks.

This fund will be able to guarantee easy credit conditions for final beneficiaries, such as zero rate loans, with a specific regional intervention in the form of an interest subsidy or capital contribution, up to €800,000 applying the temporary framework for State aid[26], and with amortization extendable to 15 years, accompanied by rapid and efficient selection of the intermediaries. Management support from an institution like the EIB guarantees effectiveness of the instrument.

With this new tool, whose conditions and technicalities are currently being developed with the EIB, the Region intends to support companies with liquidity difficulties operating in particular in the tourism, agri-food, ICT and construction sectors, independently of the size of the company. To ensure immediate leverage, the EIB may make a long-term loan available to the selected financial intermediary matching resources allocated to the fund by the Region. This initiative is welcomed by Sardinia Region and has also been proposed by the EIB to other Italian regions.

The Region also extended operations of the Inclusive Finance Fund, transforming this into a guarantee line dedicated to innovation and social inclusion. The new Social Innovation and Inclusion Fund is intended to encourage the financial inclusion of beneficiaries with difficulties in accessing credit and at risk of exclusion from the credit system. It will grant a counter-guarantee or direct guarantee in favour of businesses, economic operators and individuals. Part of this €10 million Fund will be used to create an 80% guarantee in favour of individuals who submit a request for the advancement of finance to the banking and financial system against allowances for layoffs (Cassa Integrazione Guadagni, CIG) or other forms of income support. The Region will thus facilitate credit to workers from financial intermediaries. Lenders will be able to advance up to €1,400 for the CIG at zero hours for 9 weeks with a proportionate cheque, in the case of shorter periods or if part-time. This duration is related to the coverage period provided by the "Cura Italia" decree[27] for employees in companies closed for the emergency. In case the total amount of the CIG exceeds 1,400 Euros, the bank will integrate the difference once the extra resources have been collected by the pension institution within a maximum of 7 months.

This initiative should produce significant social impact and could be accompanied by a further expansion of the scope of the Innovation and Social Inclusion Fund allowing it to issue guarantees in favour of individuals or households that make a specific request for contingent reasons and obvious financial exclusion. It could also provide social *lending* instruments to ensure loans outside the banking system to encourage the flow of immediate resources to families.

The Region has also been working since last December on innovative lending through the Sardegna Fintech platform, bonds for specific production chains, advances for invoice payments and *crowdfunding*. These instruments, for which the Region has a budget of €20 million, could be further used to guarantee liquidity, providing additional support to companies in the current Covid-19 emergency.

[26] Communication from the Commission 2020/C 91 I/01.

[27] On March 17, 2020, the Italian Government enacted the so called "Cura Italia" law decree, with the aim of issuing urgent measures to address the economic and social impact of the COVID-19 emergency (the "Decree"). The Decree was published in the Official Gazette on March 17, 2020 and became effective the same day.

Conclusions

The economic crisis caused by the Covid-19 emergency is creating significant liquidity and profitability problems for Italian companies. Although it is still difficult to provide a definitive estimate of the actual working capital requirement, it is certain that an immediate and effective response is needed to prevent this problem from pushing the economy into a deep recession. The answer becomes more urgent given a particularly critical context for Italian entrepreneurship characterised by pre-existing factors (such as delayed payments from public administrations or the high and increasing public debt), the inevitable decline in consumer demand, or a high degree of uncertainty (such as the availability of credit from the banking system). If all this is added to the fact that the end of the Covid-19 emergency is not yet predictable or if a new *lockdown* will occur in the future, the picture becomes even more worrying.

Supporting the liquidity needs of enterprises, especially SMEs, means avoiding in the worst-case scenario that they fail or, at best, drastically reduce investments. In both cases, an immediate brake is needed to stop a potential negative spiral that could produce unpredictable effects on growth and employment. The opportunities offered by the new EU Regulations, in particular 2020/460, to finance working capital through financial instruments with ESIF are significant for the Regions. For those who already activated financial instruments in the 2014-2020 programming period, it would also be an immediate way to very quickly provide financial support to local businesses that addresses high liquidity requirements.

Sardinia Region shows how it is possible to immediately exploit the openings granted by the new European Regulations. Three lessons from this case are:

• Financial instruments can offer a wide range of products (loans, guarantees and counter-guarantees) to meet the different needs of businesses. Differentiating the financial offer, even by using the most innovative tools, and then providing short, medium and long-term options for enterprises is even more important in an emergency as delicate as this one.

• An effective and efficient governance structure is essential to ensure a rapid operational response. Sardinia Region can rely on a well-established management architecture and experience with financial instruments from the 2007-2013 programming period. However, managing authorities not familiar with financial instruments can entrust their management and implementation to national or international financial institutions with the *know-how* necessary to quickly implement measures for companies in difficulty.

• Finally, in the current emergency and crisis, it is essential - and urgent – to accompany measures supporting enterprises with targeted actions also supporting workers and families. The economic recovery can only be triggered through a synergy of actions on both the supply and demand sides. Also in this case, activating financial instruments to provide liquidity to individuals can offer a significant complementary contribution to avoid a drop in demand hindering the responsiveness - and survival - of the companies themselves.

Annex: Changes in EU Regulations for working capital

<table>
<tr><td colspan="2">REGULATION (EU) 2020/460 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 30 March 2020 amending Regulations (EU) No 1301/2013, (EU) No 1303/2013 and (EU) No 508/2014 as regards specific measures to mobilise investments in the healthcare systems of Member States and in other sectors of their economies in response to the COVID-19 outbreak (Coronavirus Response Investment Initiative)</td></tr>
<tr><td>Amendment</td><td>Original article of the Regulation (EU) No 1301/2013</td></tr>
<tr><td>3(1)
In addition, the ERDF may support the financing of working capital in SMEs where necessary as a temporary measure to provide an effective response to a public health crisis.</td><td>3(1)
a paragraph is added</td></tr>
<tr><td>Amendment</td><td>Original article of the Regulation (EU) No 1303/2013</td></tr>
<tr><td>The following paragraph is added to 37(4)
Financial instruments may also provide support in the form of working capital to SMEs if necessary, as a temporary measure to provide an effective response to a public health crisis.</td><td>37(4)
Where financial instruments support financing to enterprises, including SMEs, such support shall target the establishment of new enterprises, early stage-capital, i.e. seed capital and start-up capital, expansion capital, capital for the strengthening of the general activities of an enterprise, or the realisation of new projects, penetration of new markets or new developments by existing enterprises, without prejudice to applicable Union State aid rules, and in accordance with the Fund-specific rules. Such support may include investment in both tangible and intangible assets as well as working capital within the limits of applicable Union State aid rules and with a view to stimulating the private sector as a supplier of funding to enterprises. It may also include the costs of transfer of proprietary rights in enterprises provided that such transfers take place between independent investors.</td></tr>
<tr><td>The following paragraph has been added:
By way of derogation from the first subparagraph, the Commission shall not issue a recovery order for amounts recoverable from the Member State for the accounts submitted in 2020. Amounts not recovered shall be used to accelerate investments related to the COVID-19 outbreak and eligible under this Regulation and Fund specific rules.
The amounts not recovered shall be cleared or recovered at closure.</td><td>139(7)
After the calculation carried out under paragraph 6, the Commission shall clear the respective annual pre-financing and pay any additional amount due within 30 days of the acceptance of the accounts. Where there is an amount recoverable from the Member State, it shall be subject to a recovery order issued by the Commission which shall be executed, where possible, by offsetting against amounts due to the Member State under subsequent payments to the same operational programme. Such recovery shall not constitute a financial correction and shall not reduce support from the Funds to the operational programme. The amount recovered shall constitute assigned revenue in accordance with Article 177(3) of the Financial Regulation.</td></tr>
<tr><td colspan="2">REGULATION (EU) 2020/558 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 April 2020 amending Regulations (EU) No 1301/2013 and (EU) No 1303/2013 as regards specific measures to provide exceptional flexibility for the use of the European Structural and Investments Funds in response to the COVID-19 outbreak</td></tr>
<tr><td>New article</td><td>Article of the Regulation (EU) No 1303/2013</td></tr>
<tr><td>25 a (10)
By way of derogation from point (g) of Article 37(2), no review or update of the ex-ante assessments shall be required where changes in financial instruments are necessary to provide an effective response to the COVID-19 outbreak.</td><td>37(2)(g)
Support of financial instruments shall be based on an ex ante assessment which has established evidence of market failures or suboptimal investment situations, and the estimated level and scope of public investment needs, including types of financial instruments to be supported. Such ex ante assessment shall include: provisions</td></tr>
</table>

	allowing for the ex ante assessment to be reviewed and updated as required during the implementation of any financial instrument which has been implemented based upon such assessment, where during the implementation phase, the managing authority considers that the ex ante assessment may no longer accurately represent the market conditions existing at the time of implementation.
25 a (11) **Where financial instruments provide support in the form of working capital to SMEs pursuant to the second subparagraph of Article 37(4) of this Regulation, new or updated business plans or equivalent documents and evidence allowing verification that the support provided through the financial instruments has been used for its intended purpose as part of the supporting documents, shall not be required.** **By way of derogation from Regulation (EU) No 1305/2013, such support may also be provided by the EAFRD under measures referred to in Regulation (EU) No 1305/2013 and relevant to the implementation of financial instruments. Such eligible expenditure shall not exceed EUR 200 000.**	37(4) amended by CRII proposal - REGULATION (EU) 2020/460 - by adding the following paragraph: Financial instruments may also provide support in the form of working capital to SMEs if necessary as a temporary measure to provide an effective response to a public health crisis.
Amendment	**Original article of the Regulation (EU) No 1301/2013**
3(3)(d) **Undertakings in difficulty as defined in Union State aid rules; undertakings receiving support complying with the State aid Temporary Framework or Commission Regulations (EU) No 1407/20134, (EU) No 1408/20135 and (EU) No 717/20146 shall not be regarded as undertakings in difficulty for the purposes of this point.**	3(3)(d) The ERDF shall not support: undertakings in difficulty, as defined under Union State aid rules
REGULATION (EU) 2020/560 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 April 2020 amending Regulations (EU) No 508/2014 and (EU) No 1379/2013 as regards specific measures to mitigate the impact of the COVID-19 outbreak in the fishery and aquaculture sector	
Amendment	**Original article of the Regulation (EU) No 508/2014**
Art. 55 (1) The EMFF may support the following compensation schemes: (a) compensation to mollusc farmers for the temporary suspension of the harvesting of farmed molluscs, where such suspension occurs exclusively for reasons of public health; **(b) granting working capital and compensation to aquaculture farmers.** **Compensation referred to in point (b) of the first subparagraph may be granted for the temporary suspension or reduction of production and sales or for the additional storage costs occurring between 1 February and 31 December 2020 as a consequence of the COVID-19 outbreak.**	55(1) (1) The EMFF may support compensation to mollusc farmers for the temporary suspension of harvesting of farmed molluscs, where such suspension occurs exclusively for reasons of public health.
69(3) **The EMFF may support granting working capital and compensation to processing enterprises within the scope set out in the second subparagraph of Article 55(1) for aquaculture farmers.**	Art. 69 - a paragraph has been added.

This article was written by Michele Alessandrini (t33), Clarissa Amichetti (t33) and Marco Naseddu (Financial Instruments ERDF ROP Sardinia 2014-2020)