Italian family firms in the face of Covid-19 pandemic
Executive Summary of AUB Observatory - XII edition
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Introduction

The AUB Observatory, promoted by AIDAF (Italian Association of Family Business), AIDAF-EY Chair of Strategic Management of Family Business (Università Bocconi), UniCredit and Cordusio, with the support of Borsa Italiana, Angelini Foundation and the Chamber of Commerce of Milan Monza Brianza Lodi (CCIAA), carries on the monitoring of all Italian family firms that exceed the 20 million euros turnover threshold.
The XII edition of the AUB Observatory presents the "state of health" of Italian family firms before the Covid-19 pandemic diffusion, and also what actions a subgroup of them, the listed firms, put in place in 2020 in reaction to the covid-19 pandemic. Then, for the first time, the AUB Observatory proposes a comparison among the first 1,000 Italian, German, French, and Spanish groups.
The main results are discussed in this summary. Starting from the 27th of January 2021, the reports of these and other results will be available on the AIDAF-EY website (https://www.aidaf-ey.unibocconi.it/).

The Population of the XII edition

The population of Italian firms monitored by the AUB Observatory is made up of 17,984 firms with turnover above 20 million euros, of which 11,808 are family-owned (equal to 65.6%).[1] The incidence of family-owned companies increased by 5.6% compared with that of the XI Observatory edition. A population comparison between the XII edition and the I edition of 2007 shows that the number of companies with revenues above 50 million[2] euros rose from 7,663 in 2007 to 8,255, with its lowest of 6,816 in 2009.

The first 1,000 groups in France, Germany, Italy and Spain

We expect that after the pandemic there will be greater competitive pressure between the companies of different countries. For this reason, for the XII edition of the AUB Observatory, we perform comparative analyses of family and non-family owned companies of the main European countries. In particular, the comparison between the first 1,000 groups in France, Germany, Italy, and Spain offers some interesting insights into the status of large Italian companies at the beginning of the pandemic. This comparison shows two significant elements:

[1] Firms controlled at least at 50% by one or two families (if unlisted) and at least 25% (if listed), or by a legal entity in turn related to one of the two situations described above have been considered family-owned.

[2] In 2007, the Observatory monitored all firms that exceed the 50 million euros turnover threshold.

- Family firms still represent the backbone of at least three countries: Italy (43.7%), Germany (39.5%), and Spain (35.4%). The future development of the European economic system depends significantly on the development of family firms, and this holds also for the largest companies;
- Manufacturing family firms are dominant in Italy (49%), even more than in Germany (43%). At least for these two countries, the future development of the economic system cannot disregard the development of manufacturing companies.

Three family firms' strengths emerge from the comparison of the last decade's economic financial data for the first 1,000 groups in the four countries:

- revenue growth for Italian family firms is greater than that of the other 3 countries (+86.4%, compared to 79.7% in France, 78.9% in Spain and 69.5% in Germany), bridging the gap with French and German family firms;
- Italy is the only country where the operating profitability (ROI) in 2019 of family firms exceeded that of 2019;
- the Italian family firms have a stronger financial strength than non-family firms (and this is true also for the European countries).

The economic-financial data of the last decade, therefore, seem to show that family firms (and Italian ones in particular) have reacted well to the crisis of 2009 - and to that of 2012 -, improving growth, profitability, capital and financial strength. It is now important to understand how family firms will cope with the Covid-19 crisis.

Comparing the first 1,000 groups in the four countries, four challenges emerge for the larger Italian companies, both family and non-family ones:

- increase the size: Italian companies are smaller than those in Germany and France. There are 249 companies with revenues above 1 billion euros in Italy, compared with 608 in Germany and 381 in France. Considering the ratio between the German GDP and the Italian one, in Italy we should have around 322 companies (33% more) of that size;
- accelerate the growth by increasing the number of acquisitions: in the last twenty years (between 2000 and 2019) the number of acquiror firms is more or less equal to 40% in all countries. Yet, German and French companies made more than twice the number of acquisitions of Italian firms (8.4 acquisitions per company, against an Italian average of 3.7);
- open up to the capital market: fewer Italian firms are listed on the Stock Exchange compared to European counterparties (7.4% compared to 13.4% in Germany and 17.3% in France). Yet, Italian listed family firms are more than Italian listed non-family firms (11% compared to 4.6%);
- bridge the gender gap in the board of directors and leadership roles. This challenge affects all European companies.

Whilst opening up to the capital market and closing the gender gap are of major concern also for all European countries, Italian firms have to work hard on all four challenges. The gap with France and

Germany is wide, but it can be closed, also thanks to the good job of Italian companies in the last decade.
Looking at the corporate governance structure, two challenges seem to emerge for Italian family firms:

- open up the leadership and boards of directors to non-family members. Just an example: in Italy 73% of leadership positions are filled by family members, while in Germany only 17% of members in executive boards and 33% in supervisory boards are family members;
- open up to young leadership: leaders older than 70 years count for 29% in Italy, against 23% in France, 22% in Spain and 7% in Germany.

The economic and financial structure of Italian family firms at the beginning of 2020

The updated economic and financial data of the XII edition of the AUB Observatory show that Italian family firms at the beginning of the pandemic had the following structure:

- the return on equity (ROE) and return on investment (ROI) remain high (11.6% ROE and 8.8% ROI), even if lower than 2017 values (20% and 9% respectively);
- the Debt / Equity ratio - equal to 3.3 - shows an improvement of 33% compared to 2011 (when it was 4.9);
- the NFP / EBITDA ratio - equal to 4.8 - has an improvement of 16% compared to the peak of 2012 (when it was equal to 5.7);
- the NFP / EQUITY ratio - equal to 1.4 - shows an improvement of 26% compared to 2011 (when it was 1.9).

Based on these indicators, we identify a group of companies that we define as “unfit” to cope with the 2020 crisis from the financial and economic point of view. Among those firms characterized by critical financial situations, it is possible to include family firms with:

- EQUITY with negative values (equal to 0.1%);
- EBITDA with negative values (equal to 2.8%);
- both EQUITY and EBITDA with negative values (equal to 0.5%);
- “critical” values of both NFP / EQUITY and NFP / EBITDA ratios (equal to 23.5%)[3];
- “warning” values of both NFP / EQUITY and NFP / EBITDA ratios (equal to 6.4%)[4].

Therefore, from these data, it emerges that at least 33.3% of Italian family firms have an inadequate financial structure at the beginning of 2020 to cope with the pandemic.

To better evaluate the status of family firms at the outbreak of the Covid-19 pandemic, we compare the values of the above-mentioned indicators between early 2020 and early 2009. The comparison shows that:

[3] The companies with financial strength indicators considered "critical" are those with: i) a NFP / EQUITY ratio> 5; ii) a NFP / EQUITY ratio between 3 and 5 and a NFP / EBITDA ratio> 4; iii) a NFP / EQUITY ratio between 0 and 3 and a NFP / EBITDA ratio> 5.

[4] The companies with financial strength indicators considered “warning” are those with: i) a NFP / EQUITY ratio between 3 and 5 and a NFP / EBITDA ratio <4; i) a NFP / EQUITY ratio <3 and a NFP / EBITDA ratio between 4 and 5.

- the incidence of companies with a "compromised" capital structure in early 2020 was lower than that in early 2009 (the % of companies with negative values of EQUITY and/or EBITDA dropped from 4.3% to 3.4%);
- the incidence of companies with "critical" or "warning" financial strength indicators fell by about 10 percentage points (from 38.8% in 2020 to 29.9% in 2019);
- the incidence of companies with negative values of NFP - i.e. liquidity higher than financial debt - increased from 17.7% in 2019 to 29.5% in 2020.

The X edition's data show that the crisis of 2008-2009 led 17.5% of Italian family firms to enter liquidation and insolvency procedures over the period 2009-2018. By applying the same proportions, and by taking into consideration the improved situation of companies at the beginning of 2020 as outlined above, we can expect that 13.5% of Italian family firms could enter liquidation or insolvency proceedings over the next decade.
Yet, according to the IMF Outlook[5], the 2020 crisis is expected to have a greater negative impact on Italian and international GDP compared to that of 2008-2009 (estimates expect it to be twice as negative as 2008-2009 one). If the recovery of the next few years does not improve to that of the past decade, it can be estimated that between 25% and 30% of Italian family firms may enter liquidation or insolvency proceedings over the next decade.

The impact of the financial structure on the economic and financial performance

Given the above challenges emerged by the comparison with German, French and Spanish companies, together with the financial conditions of Italian family firms at the outbreak of the Covid-19 pandemic, we carried out in depth-studies – with the support of FSI - on the impact of debt level on companies' economic and financial performance. The results of these analyses show that:

- there is a negative relationship between the starting level of debt of a company (measured by NFP / EBITDA and NFP / Equity ratios, previously mentioned) and the financial performance (in term of growth and profitability) in the following 5 years;
- an increase in the amount of debt harms performance both in terms of growth and profitability, also in case of companies with a low starting amount of debt (below the median).

These results confirm that to overcome the challenge of dimensional growth, together with a greater number of acquisitions, the successful family firms must "work" mostly on increasing equity rather than debt. Besides, greater involvement of non-family investors can help to address two of the challenges that emerged previously with regard to the governance structures, namely the challenges to increase the presence of both non-family directors and younger leaders in family firms.

[5] International Monetary Fund (source: https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD)

The reaction of the listed companies during 2020

We performed two up-to-date analyses on the 351 Italian listed companies: the first took into accounting measures performance, while the second one focused on stock performance. The first analysis shows us that from 1st January to 30 June 2020 Italian family firms recorded operating profitability (ROA) of 4.3% higher than non-family firms[6].
Comparing the first half of 2020 with the first half of 2019, family firms recorded on average:

- A 10.1% decrease in revenues against an 11.9% reduction of non–family firms' revenue.
- An increase in employment of 3.4% compared to a 1.4% reduction of non-family firms' employment.

The second analysis on the stock performance for the entire 2020 shows that an overall increase in share prices of family firms 22.3% higher than that of non-family firms[7]. The results demonstrate that the accounting performance of family firms in the first semester of 2020 were better, albeit by a small extent, than those of non-family firms, and that investors throughout 2020 appreciated the reaction of family firms to the Covid-19 pandemic.

Eventually, an analysis was conducted on the actions taken by listed family and non-family firms to cope with the effects of the pandemic. The analysis was performed on a sample of 310 companies listed on the Milan Stock Exchange (excluding banks and insurance companies). The data refer to the second, third and fourth quarters of 2020 and are based on the analyses of the first three quarterly company reports published in 2020 (as of 31.03.2020, 30.06.2020 e 30.09.2020) and of the press releases published until December 2020. The following results emerge from the data:

- 29% of family and non-family firms declared that they had already adopted smart-working as a form of work before the outbreak of the pandemic. During 2020, the percentage of companies that declared to adopt smart-working rose to 87%. Family firms, which started from a smaller number (25%), reached 85%. This confirms that the strength of Italian firms is characterized by their ability to react, even if with some delays in terms of job organization. When innovation is necessary, they are able to quickly adapt to the new context. This is primarily due to very short chains of command that make it possible to decide and implement changes quickly;
- during 2020, around 30% of family firms made monetary donations. This incidence is lower than that of non-family firms (37%), yet, looking at the total amount of donations about 2/3 of monetary donations (equal to about 100 million euros) are made by family firms and 5 of the top 8 firms (by the amount of donation) are family-owned. Furthermore, even comparing

[6] The analysis was carried out with an OLS regression model on operating profitability (ROA) of the first half of 2020. The regression model included the following controls: age of the company, company size, debt ratio, stock segment, sector (Ateco 4-digits code).

[7] The analysis was carried out with an OLS regression model calculating the CAPM-adjusted daily returns ("cumulative abnormal returns") from January 1st to December 31, 2020. The beta CAPMs were estimated using the daily returns from January 2017 to December 2019 and using the FTSE-All Shares as a market index. The result was also confirmed with a Difference-in-Difference (DiD) regression model using the analysis of CAPM-adjusted daily returns ("abnormal return") in the same time period (January 1st - December 31).

the amount of donations to the company's turnover, it can be observed that the incidence of donations made by family firms is on average higher than that of non-family firms. It is confirmed that family firms aim at establishing "community" relationships in which beyond any ideological interpretation, the entrepreneur tries in every way to help his community, even in front of objectively difficult context.

- regarding the adoption of security protocols and e-commerce platforms (B2B and B2C), there is a strong similarity between family and non-family firms. More than 3 out of 4 companies (both family and non-family) have developed ad hoc plans to ensure a safe work environment and protocols to follow in case of positive virus tests, also including the possibility for employees and their families to perform swabs or serological tests. Similarly, approximately 43-44% of firms (family and non-family) have implemented e-commerce platforms of either the B2B or B2C type, during the lockdown period or later to meet the changing needs of demand.