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Chapter

# ESG for SMEs: Can the Proposal 2021/0104 for a European Directive Help in the Early Detection of a Crisis?

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## Abstract

With the proposal for a European Directive 2021/0104, the number of entities who will be required to prepare a non-financial statement (NFS) has been broadened. The directive provides that small and medium-sized enterprises (SMEs) may also voluntarily opt for drawing up a non-financial statement. It is therefore important to identify reporting standards containing key performance indicators (KPIs), tailored to the characteristics and structure of SMEs. In addition to the potential advantages in terms of improvement in relationships with stakeholders, NFI could be relevant for an early diagnosis of crisis signals therefore, an early warning behavior. This paper, therefore, aims to analyze how non-financial information can be a valuable aid to all governance players in identifying those first signs of crisis. In Italy, Organismo Italiano Business Reporting (OIBR) is drafting a document that promotes the use and communication of non-financial information on the part of SMEs with the dual objective of demonstrating that corporate governance structure on the one hand, and management and accounting tools on the other should be adequately designed and functioning so as to prevent a company's exposure to the risk of failing to operate as a going concern.

**Keywords:** non-financial reporting directive—NFRD, sustainability financial disclosure, non-financial disclosure, non-financial KPIs, crisis, Italian civil (IC)-code, Italy, early warning system, SMEs, family firm, going concern, corporate governance, ESG risks

## 1. Introduction

With the entry into force of *Codice della Crisi d'Impresa e dell'Insolvenza* (Italian Corporate Crisis and Insolvency Code, Legislative Decree No. 14/2019), new obligations have been set forth in regard to the establishment of an organizational, administrative, and accounting model adequate to a company's nature and size. The legislature's objective is to encourage companies to adopt a preventive approach in management, which favors quick action when the first signs of decline or crisis occur. Underlying the adoption of the alert system governed by the crisis code, a number of indicators must be set up capable of predicting a state of crisis and the extent of its severity. Situations of potential decline or true crisis should thus be

intercepted and confirmed by indexes and indicators that represent a wealth of information available to company management and corporate bodies. In order for all this to take place effectively, financial indicators need to be accompanied by other non-financial indicators. Likewise, to verify the adequacy of a company's organizational, administrative, and accounting model, which is in turn (also) necessary for the production of information to calculate the crisis indexes, it is appropriate to use indicators that are not only financial in nature. The proposal for a European Directive 2021/0104 of April 21, 2021 provides for a significant increase in the number of entities required to draft the non-financial statement (NFS), including listed companies with fewer than 500 employees, i.e. SMEs whose securities are traded on the market and large companies even if not listed. It does not introduce mandatory drafting of the NFS for SMEs but provides that they may opt for voluntary drafting of a structured non-financial disclosure to be included in the management report, rather than in a separate document, according to specific standards and in compliance with the principle of proportionality.

The aim of this paper is to reflect on the role of non-financial information in early warning. The authors formulate the hypothesis that, since this specific category of information is forward-looking and focuses the company's management's attention on the business outlook, it can certainly prove to also be valuable for the opposite, complementary purpose of intercepting and identifying critical situations in the future.

## 2. Disclosing non-financial information: a review of the literature

The idea that financial indicators were not enough to measure business performance began to take hold in the early 1980s. In this sense, Itami [1] introduced the concept of creation and consumption of invisible resources, defined as resources based on information. According to Itami, the strategy requires effective harmony between five areas: customers, competitors, technology, resources, and corporate organization; for each of these, "invisible" resources play an essential role. To be successful, good strategies require a great number of such invisible resources to be mobilized, whose creation must have been carefully planned for some time [2].

Attention to intangibles later led to the development of a parallel reporting structure [2–4]. Over time, all models proposed a number of indicators aimed at monitoring management aspects related to knowledge, sometimes constituting inputs of learning processes, other times constituting more or less direct outputs [5–7]. The originality of these models does not consist in the search for new indicators, as in the case of Skandia, but in the attempt to systematize them, in search of a criterion whereby to organize indicators in order to shed light on the various areas of knowledge management and represent their link with value creation [8–10]. From this standpoint, three macro-areas around which to develop measurement parameters were emphasized. The first refers to customer relations in terms of relationships, image, and knowledge of tastes and preferences (defined as "external structure" by Sveiby, or "customer capital" by Edvinsson-Malone). The second is the area of expertise held by corporate staff, mainly consisting of implied knowledge (defined as "competence of personnel" by Sveiby, and "human capital" by Edvinsson-Malone). The third is the area of the wealth of knowledge that has sedimented within the organization in general, mainly, although not exclusively, consisting in codified knowledge (defined as "internal structure" by Sveiby and "organizational capital" by Edvinsson-Malone). Within these three macro-areas, the above scholars proposed a number of indicators capable of representing

intangible capital as a whole and the knowledge that forms an essential part of it. This category over time has been typically referred to as intellectual capital [3, 4], with widespread use in practice, especially by the more proactive knowledge-intensive companies.

Since the adequacy of a management control system depends on the market in which the company operates, some non-financial performance indicators may be inadequate. In general, the element that seems to affect the choice of non-financial performance indicators to a greater extent is strategy, which in turn depends on the competitive environment. Other frequently monitored non-financial performance indicators are market share, productivity and innovation rates, and the education level of management.

In the early 1990s, R. Kaplan and D. Norton [11, 12] found that the balanced scorecard as a management reporting tool, now widespread among companies, which could combine the dimensions of management efficiency and effectiveness, finance, internal production, learning, and innovative knowledge development and customer relations [13].

The affirmation of key performance indicators (KPIs) in management control systems also involved gradual dissemination thereof in financial communications to investors. In the mid-1990s, papers began to appear proposing the inclusion of performance measurements in financial reporting, while at the same time analysts were using them increasingly. In 1991, the American Institute of Certified Public Accountants—AICPA [14] set up a commission with the aim of formulating proposals to supplement the financial statements, considered by many to be no longer sufficient to satisfy the increased demand for information by those interested in the company's events in various capacities, by requiring: (i) more information about the company's plans, opportunities, risks and uncertainties, (ii) greater emphasis on factors that create long-term value, including non-financial data that detect how key business processes are performing, (iii) improved alignment between the reports disclosed externally with the information made available internally to top management for the purpose of managing the business [15].

The committee's work, known as the Jenkins committee, started from an in-depth survey of users of accounting and financial information and companies providing such information and led to the publication of a report in 1994: *Improving Business Reporting—A Customer Focus* [16, 17]. It required the inclusion in the financial statements of financial and non-financial data and performances arising from analyses conducted by management, as well as information and forward-looking estimates on risks and opportunities, business plans, critical success factors, and a comparison between approved plans and performance achieved (**Table 1**) [18]. For financial statements to be effective, they need to contain a significant amount of information other than purely financial information. The latter is contained only in point I. A—*Financial Statements and Related Disclosures.* In fact, the model requires specifying the number of other details, including:

- High-level operating data and performance indicators that top management uses for the purpose of managing the business;

- Circumstances and reasons underlying any changes recorded in operating and financial data, nature, and effects of the key trends;

- Forward-looking information and estimates, including opportunities and risks associated with key trends, management plans, critical success factors, and a comparison between the corporate performance actually achieved with the top management's plans and previously reported opportunities and risks;

| AICPA—1994—model of business report | | |
|---|---|---|
| I. | Financial and nonfinancial data | a. Financial statements and related disclosures. |
| | | b. High-level operating data and performance measurements that management uses to manage the business. |
| II. | Management's analysis of financial and nonfinancial data | a. Reasons for changes in the financial, operating, and performance-related data, and the identity and past effect of key trends. |
| III. | Forward looking information | a. Opportunities and risks, including those resulting from key trends. |
| | | b. Management's plans, including critical success factors. |
| | | c. Comparison of actual business performance to previously disclosed opportunities, risks, and management's plans. |
| IV. | Information about management and shareholders | a. Directors, management, compensation, major shareholders, and transactions and relationships among related parties. |
| V. | Background about the company | a. Broad objectives and strategies. |
| | | b. Scope and description of business and properties. |
| | | c. Impact of industry structure on the company. |

**Table 1.**
*Structure of the business report proposed by the AICPA.*

- Information regarding the remuneration of directors, management, and major shareholders and relationships among related parties.

The positive effect of NFPI was not limited to reducing management-ownership asymmetries. The measurement of performance using qualitative tools also brought benefits from a purely operating standpoint. In general, it can be argued that monitoring company performance by taking into account qualitative elements has made it possible to intercept signals coming from the market (customer relations, changes in the competitive environment, etc.) in advance with respect to what would be possible by adopting exclusively financial indicators. This has allowed management to promptly take corrective actions in order to prevent difficult situations that could, if left unmanaged, lead to a crisis and even to insolvency.

Therefore, the processing and representation of non-financial information before the adoption of the crisis code played a "subsidiary" role with respect to corporate reporting, which had until then almost exclusively regarded financial data [19–36].

Article 2086, paragraph 2, of the Italian Civil (IC) Code, which was introduced under the crisis code, and the provisions governing warning systems contained therein, allow individual companies to attribute relevance to specific factors, which, taking into account the company's peculiarities, are more suitable "to grasping a possible state of crisis" [37]. Non-financial, qualitative indexes are certainly included among these.

## 3. Proposal for a European directive 2021/0104 of April 21, 2021

In December 2019, the Council emphasized the importance of reliable, comparable, and relevant information on sustainability risks, opportunities, and impacts [38], and called on the committee to consider European non-financial reporting standard [39].

In the May 2018 resolution on sustainable finance, the European Parliament called for further development of reporting requirements within the framework of the Non-Financial Reporting Directive (NFRD) [40]. In its December 2020 resolution on sustainable corporate governance, it welcomed the commission's commitment to review NFRD, called for the scope of NFRD to be extended to other categories of companies, and welcomed the commission's commitment to the development of EU non-financial reporting standards [41]. The European Parliament also believes that non-financial information released by companies under the NFRD should be subject to mandatory audits. The main users of the sustainability information disclosed in the company's annual report are investors, non-governmental organizations (NGOs), social partners, and other stakeholders. Investors, including asset management companies, want to better understand the risks and opportunities of sustainability issues of their investments, as well as the impact of these investments on humans and the environment. NGOs, social partners, and other stakeholders hope to give more consideration to the impact of their activities on humans and the environment by committing to [38].

The current legal framework does not ensure that the information needs of these users are met. This is because some companies whose users wish to obtain sustainability information do not report such information, while many companies that report sustainability information do not report all information related to users. When reporting information, companies are often neither reliable nor comparable. It is often difficult for users to find this information, and it is rarely provided in a machine-readable digital format. Information about intangible assets, including intangible assets generated internally, is undervalued, even though these intangible assets represent the bulk of private sector investment in advanced economies (such as human capital, brands and intellectual property rights, and intangible assets related to R&D) [38].

In recent years, users' information needs have increased significantly, and they will almost certainly continue to increase. There are several reasons. One is that investors are increasingly aware that sustainability issues may put the company's financial performance at risk. The other is a growing market that explicitly seeks investment products that meet certain sustainability standards or achieve certain sustainability goals. Finally, the COVID-19 pandemic may further accelerate the growth of companies' demand for sustainability information, for example regarding worker vulnerability and supply chain resilience [38].

For companies that must report, the current situation is also problematic. Current requirements lack accuracy, and there are a large number of proprietary standards and frameworks, making it difficult for companies to know exactly what information they should report. They often encounter difficulties in obtaining the information they need from suppliers, customers, and investee companies. In addition to the information reported in order to comply with current legal requirements, many companies also receive requirements from stakeholders for sustainability information. All these will incur unnecessary business costs. Therefore, the declared goal of the directive proposal is to improve the sustainability report at the lowest possible cost, so as to make better use of the potential of the European single market and promote the transition to a fully sustainable and inclusive economic and financial system in accordance with the European Green Agreement and the United Nations sustainable development goals [38].

There are many important international initiatives already in place. Their goal is to help achieve global integration and unification of sustainability reporting standards. The IFRS Foundation's proposal to create a new sustainability standards committee is particularly important in this regard. Work has been carried out by established initiatives including the Global Reporting Initiative (GRI) and

the Sustainability Accounting Standards Board (SASB) the same is true of the International Integrated Reporting Committee (IIRC), the Climate Disclosure Standards Board (CDSB), and CDP (formerly known as the Carbon Disclosure Project). The proposal consists of a directive that will modify four existing legislations. First, it will revise the accounting directives, revise some existing clauses and add some new clauses on sustainability reporting. In addition, it will revise audit directives and audit regulations to cover audits of sustainability information. Finally, it will amend the transparency directive, extend the scope of sustainability reporting requirements to companies whose securities are listed on the regulated market, and clarify the regulatory system of these companies on sustainability reporting [38].

At the domestic level, the document "*Il Reporting Integrato delle PMI: Linee guida operative e casi di studio*" (Integrated Reporting of SMEs: Operational Guidelines and Case Studies) is particularly relevant. It was the result of the activity of Network Italiano Business Reporting (NIBR, Italian Business Reporting Network), which—as Organismo Italiano Business Reporting (OIBR) today represented the WICI global network Italian jurisdiction from 2012 to 2018. The English version of the document was published in 2018 in collaboration with IIRC and the WICI Network, and its preparation was resumed and concluded by OIBR in Italian in October 2019.

The guidelines show that integrated reporting not only represents an evolved form of reporting capable of enhancing an organization's relationships with its stakeholders, but also constitutes a tool that can provide business owners and managers with a full and complete view of the company's business activities and can satisfy the information expectations of financial institutions and banks, who are not only interested in year-end but above all in forward-looking and strategic information. In this view, the time devoted to the preparation of the integrated report should not be considered a cost for the company, but an investment that produces returns in terms of organizational efficiency, optimization of resources and capital, development of strategies, sharing of objectives, and measurement of performance.

The above document preliminarily emphasizes a terminological distinction, defining "Business Report" as a document designed to represent, measure, and illustrate an organization's operating and strategic activities and related impacts on economic, financial, and social performance. A fundamental feature of the business report is to combine narrative description with quantitative metrics and indicators, not directly derived from the organization's accounting system. These indicators take the form of key performance indicators (KPIs), expressed with non-financial metrics, and therefore not through monetary units of measurement but, for example, through percentages, physical measurements, Likert scales, and so on.

The "Integrated Report" represents a particular form of business report, i.e. a concise disclosure that aims to illustrate and show stakeholders how an organization's strategy, governance, performance, and business outlook will allow it to create value in the short, medium, and long term in the context in which it operates. Such a report supplements and completes traditional financial statements.

The integrated report focuses on the concept of materiality of the information reported [42]. Therefore, each organization must identify the indicators that best express their specific corporate objectives, providing the reader with relevant, complete, illuminating, and comparable information. In this regard, the guidelines present some general KPIs, sector-specific KPIs, and company-specific KPIs, but for illustrative purposes only. Moreover, the integrated report should be able to represent the specific risks and opportunities that affect the organization's ability to create value and to explain how such elements are managed. For this purpose, it

is advisable for companies to identify key risk indicators (KRIs), useful for representing risk factors related to their core business. The guidelines also present some specific company KRIs, again by way of example.

Also within the national context, a growing interest in reporting that is not limited to financial information but also extends to "non-financial" information may be noted on the part of institutions that traditionally deal with financial and accounting issues. In this regard, for example, the conference organized by Organismo Italiano di Contabilità (OIC, Italian Accounting Board) in December 2020 concerning the consultation paper on sustainability reporting published by the IFRS Foundation, was particularly significant. In it, the need to develop a non-financial information system that can support widely proposed sustainability policies was once again emphasized.

## 4. The impact on SMEs

The 2021/0104 Directive Proposal uses a corresponding method to determine which companies will be subject to mandatory reporting requirements. Except for SMEs listed on the EU regulatory market, no new requirements have been imposed on SMEs. The proposal exempts listed micro-companies from mandatory reporting obligations [43]. The committee will adopt standards for large companies and separate and proportionate standards for SMEs. SME standards will be adjusted according to the capabilities and resources of such companies. Although SMEs listed on a regulated market will be required to use these ratios, non-listed SMEs (the vast majority of SMEs) can choose to use these standards on a voluntary basis [38].

To ensure investor protection, all companies listed on a regulated market should, in principle, comply with the same disclosure rules. Therefore, SMEs listed on the EU regulatory market must meet the proposed new sustainability reporting requirements [44]. However, the requirements for SMEs listed on the EU regulatory market will only apply 3 years after they are applied to other companies to take into account the relative economic difficulties faced by small companies due to the COVID-19 pandemic. When sustainability information reporting and assurance practices reach a higher degree of maturity, this stage will also allow listed small and medium-sized enterprises to apply new requirements. The proposal does not require other SMEs to report sustainability information. However, non-listed SMEs may decide to use on a voluntary basis the sustainability reporting standards that the commission will adopt as delegated acts for reporting by listed SMEs. These are designed to enable any SME to report information in a cost-effective manner in response to a large number of requests for information they receive from other companies with which they do business (such as banks, insurance companies, and large corporate customers), and to help determine limits companies can reasonably expect information provided by SMEs in their value chain. Such standards should also help SMEs attract additional investment and funding, and fully participate in and promote the transition to a sustainable economy outlined in the European Green Agreement [38].

## 5. The Italian path: integrated reporting for SMEs

The document *Linee Guida per il Report Integrato delle PMI* (Integrated Reporting Guidelines for SMEs) was published by NIBR (Italian Network of Business Reporting) in 2018, aiming to give the IIRC Framework a specific connotation for small and medium-sized enterprises, providing them with a methodological orientation tool that could support them in the adoption of the

Integrated Report. The basic idea is that, for SMEs, Integrated Reporting could be the appropriate instrument to deal with all, public and private, organizations that in any way affect the value creation process, providing disclosures on the company's past and future [45]. An Integrated Report must first of all provide a general overview of the organization's activities and the context in which it operates. In particular, there must be information regarding the inside of the organization, such as its mission and vision, strategies and objectives, and information regarding the external environment, such as the socio-economic context of reference, or the characteristics of the market in which the organization competes. SMEs, which are often characterized by family ties, should represent this information in the report appropriately in order to clarify the typical peculiarities of their company for the users' benefit.

The NIBR, in its paper entitled Integrated Reporting for SMEs: Implementation Guidance (2018), provides instructions on some KPIs to be used as risk and performance indicators. In particular, KPIs are divided into general indicators, sector-specific indicators, and company-specific indicators. The latter can be used by the company to best represent its expertise and peculiarities in the value creation process. In particular, these indicators should be correlated with the organization's strategic objectives, should effectively represent the value creation process, and should be reliable and comparable. Although there is no specific limit on the choice of KPIs to be included in the report, an SME should, in line with the principles set out above, select only those that are appropriate to representing its value creation process. Therefore, indicators should be chosen so as to be useful for summarizing and effectively representing the organization's current situation and future prospects, avoiding the redundancy of information that could hinder its completeness and clarity, rather than favor it. In particular, general KPIs could be entered in the initial part of the Integrated Report, in the section in which a general overview of the organization is provided, and sector-specific indicators could be set out in the section on performance thereunder. An organization is expected to provide KPIs that cover all operating processes and activities and are able to adequately describe the uniqueness and peculiarity of its value creation process. When using sector-specific KPIs, or even KPI's specifically concerning the organization, it will be necessary to add a section at the end of the report containing keywords and an explanation of the various indicators used, in order to make them understandable and practical for all users.

## 6. Draft of the OIBR 2021 report: "NFI for adequate corporate governance models and for early warnings system"

It has been frequently mentioned in previous paragraphs that non-financial indicators play a crucial role, in that, breaking away from an accounting approach, they are oriented to the future and, therefore, have a high forecasting value. However, it has also been mentioned that it is not easy to identify non-financial indicators that may be adequate to represent the company's future prospects. To do this, it is necessary to have accurate and full knowledge of the business and management events, being able to identify which are the critical success factors that should be taken into consideration. To this end, companies should implement an efficient management control system, which almost seems to become implicitly enforced [46] in order to fulfill the requirement to adopt an adequate organizational, administrative, and accounting model (pursuant to Article 375 of the Italian Code of Corporate Crisis and Insolvency), but also in order to identify the correct

non-financial KPIs to be used for identifying potential situations of crisis [47]. For their construction, this type of indicator requires a careful assessment of the risks to which a company is exposed. A risk management system facilitating risk detection, measurement, acceptance, and response and favoring the choice of risk to be avoided with respect to risks that can be mitigated or transferred to others, is essential for the construction of non-financial indicators useful for controlling the status thereof on a forward-looking basis.

In this regard, in Italy, the Working Group on "NFI for Adequate Corporate Governance Models and for Early Warnings System", set up in 2020 within Organismo Italiano Business Reporting (OIBR, Italian Business Reporting Body) is preparing a document with which it aims to identify a basket of indicators for crisis prevention also applicable to SMEs [48].

The work carried out resulted in a paper, currently still in the form of a draft, which analyses:

- Description of the state of the art stating, which are the main sources that represent references for non-financial information in the institutional, professional, and academic spheres. Generally accepted international and national principles and papers issued by professional associations were mapped for such purposes. Some essential theoretical contributions were also recalled, providing an understanding of their development also in historical terms. This mapping makes it possible to highlight how, on the one hand, the need to provide information on governance, i.e. on a company's corporate organizational model and arrangement and the effectiveness thereof for the purpose of monitoring assumed and potential risks, has so far been emphasized by many, while on the other hand, there has not yet been any specific attention to the issue of identifying the likelihood of a future crisis using non-financial indicators;

- Development of a benchmark method to describe organizational, administrative, and accounting models by using NFI supplementing the financial statements of SMEs;

- Identification of KPIs for forecasting crises by proposing a set of possible non-financial data, which, alongside the financial indicators already identified by CNDCEC, may be useful for forecasting situations of crisis. Reference principles and documents are usually set and drafted on a going concern basis and therefore propose the interpretation of non-financial information, structurally closer to the company processes and stakeholders and therefore structurally forward-looking, to assess the company's business outlook. The paper proposes an interpretation of these indicators in an opposite way, emphasizing not the demonstrative value of attractive and positive elements, but they are preventive potential useful for effective detection of risks and consequently for the planning of pre-emptive actions.

### 6.1 Reporting on "adequate models"

The draft paper of the OIBR Working Group emphasizes the need not only to implement a new model but also to report the arrangement thereof to stakeholders in the financial statements, as good governance and a well-established accounting and administrative model are necessary bases, albeit insufficient, for proper business management.

### *6.1.1 Corporate governance model*

Virtuous and transparent governance rules favor the implementation of effective risk management systems, compliance procedures with respect to the rules governing the various sectors, management controls for the timely disclosure to governance bodies of information on management trends, and, consequently, of any corrective actions to be taken. Smaller enterprises have historically been characterized by a greater blend between the company's and the family's purposes and by a habit of making decisions and planning actions, even extraordinary transactions, without having at their disposal adequate and robust, final and forward-looking, reporting tools; the lack of attention to corporate governance tools, often considered burdensome constraints rather than necessary safeguards for maintaining a company's going concern assumption, has been associated with a reduced presence of professional subjects in charge of control and supervision and with the resulting limited corporate engagement between control and management departments.

### *6.1.2 Administrative and accounting model*

Reporting on the administrative model makes it possible to highlight the company's ability to collect information and build dashboards that are essential for a type of management style based on knowledge and rationalization of company events.

It will therefore be necessary to provide information on the planning and control (or management control) process. Strategic planning can be defined as a process by which the company's strategic objectives and methods aimed at achieving such objectives, are decided and resources (investments) allocated. Strategic planning is followed by operational planning and budgeting. Both strategic planning and operational planning, and the related budgeting phase, presuppose a phase in which qualitative and economic information is gathered. The objectives to be pursued and actions to be undertaken will be decided in advance on the basis of such information. The strategic planning process, however, differs from the budgeting process in terms of time horizon and for the "language" used (qualitative and descriptive with few succinct values in strategic planning, quantitative and monetary in budgeting), in terms of relations with organizational departments and in terms of business responsibilities since, normally, only the budget is arranged according to centers having economic responsibilities and therefore according to the existing organizational model.

With regard to the accounting model, it will be necessary to provide information on the presence and arrangement of the general accounting system and analytical accounting system. The general accounting system consists of a set of tools and procedures necessary to correctly detect business management events and systematically report the values originating from business operations in chronological order. It must be adequate to the company's size and characteristics, as required by the rule contained in the second paragraph of Article 2086 of the Italian Civil Code. Regardless of the company's size and characteristics, a general accounting system cannot be considered to be adequate unless it is supported by a record-keeping system capable of representing management events both in financial and in economic and equity terms. An adequate record-keeping system, implemented within a broad management planning and control system, is decisive for the timely detection of signals of crisis. Analytical accounting is considered important corporate information and decision-making tool, as: it enables the evaluation of each individual corporate area; examines the results achieved with respect to the targets, defining their composition, analyzing the process that has caused that result; it enables the formulation of strategic choices with reference both to individual company

divisions and to management as a whole. It is therefore both an information tool and a useful tool for the interpretation of business phenomena.

### 6.2 NFI for forecasting crises

The draft paper of the OIBR working group identifies KPIs for forecasting crises by proposing a set of possible non-financial data and structuring them according to the possible external and internal stakeholders.

#### *6.2.1 External relations*

The components considered relevant to describe how a company has set up its external relations, and therefore if there are any critical issues in such respect, are as follows:

- Corporate environment: Every event has repercussions on a company: knowing the factors for this, even those over which the Company has no control, is, therefore, crucial to understanding such repercussions. The identification of issues that have the following two characteristics constitutes the basis of the analysis: the issue is beyond the control of the company and it will have a certain level of impact on it. Once all "issues" have been identified, it will be necessary to identify the implications and likelihood that the related event will occur. The corporate environment, considered in the context of external relations, refers to the (external) environment in which the company is situated and relationships established with it. Obviously, the extent of this environment derives from the policies and strategies pursued by the company, from its size and internationalization choices. It follows that the environment is a very important dimension for the prediction of corporate crises, even though most of the variables that characterize it are not directly controllable by the company, especially if it is small or medium-sized;

- Corporate reputation: Preparing a dashboard of non-financial KPIs relating to the topic of corporate reputation is a particularly important element for the forecasting of corporate crises. Corporate reputation rests on three key pillars [49]: product quality, ability to engage, and degree of authenticity. To reduce reputational risk, one of the first things to do is obviously to minimize the causes that may trigger a reputational crisis as far as possible [50]. One of these causes often lies in improper, reckless, inconsistent, and non-genuine corporate communication [51] and marketing activities, whose basic functions consist in conveying "promises" outside the company about the quality level of its products, initiatives for the benefit of the community and informing the public of the actual results achieved by the organization;

- Financial institutions: Relations with financial institutions are significant in crisis situations and in the preceding phases typically characterized by financial stress, the presence of outstanding debt, and widespread payment delays. The debt structure of small and medium-sized enterprises often suffers from an imbalance towards the debt with respect to equity; debt is frequently owed to banks and financial institutions and is often short-term. It, therefore, becomes central to develop KPIs that may provide adequate information on the structure and evolution of transactions with lenders over time, their nature, the number of active lenders, the technical financing methods and repayment terms and guarantees in place;

- Customers: Providing non-financial KPIs on the size of a customer is certainly an important element in forecasting corporate crises. The first step towards the definition of KPIs in regard to customers consists in the translation of the corporate strategy into targets that may stand as market benchmarks, i.e. a demand segmentation process aiming to identify customer groups with similar needs served by the company. Setting up a dashboard of indicators could make it possible to understand: (i) on a forward-looking basis, whether the company's distinctive expertise is capable of retaining existing customers by consolidating its corporate positioning and ability to acquire new customers; (ii) in a final evaluation, what is the current composition and solidity of parties already supplied, noting the degree of concentration and longevity of open positions, thus assessing the risks, including financial risks, connected to the activities being carried out;

- Suppliers: The bargaining power of suppliers and thus their ability to impose their terms of sale is influenced by a number of factors, including the number of major suppliers, availability of substitute materials, contribution to the qualitative characteristics of the company's products, costs for exiting the relationship and risk of downstream integration. The analysis of these factors makes it possible to obtain relevant information that influences the company's strategic decisions and has an impact on its competitive positioning. From a more global perspective, it is appropriate to appreciate the activities carried out by the company in relation to the entire supply chain, including the management of materials and information systems used for all parties involved in the creation of products or services, order fulfillment, and tracking of significant information relating to supplies. Setting up a dashboard of indicators could make it possible to understand: (i) on a forward-looking basis, whether the company's transactions with suppliers are sufficiently stable and whether there is a conscious mapping and management of the supply chain and therefore of the flow of goods, data, and cash; (ii) in a final evaluation, what is the current composition and solidity of the suppliers, identifying any concentrations of orders and assessing any risks that may derive therefrom.

*6.2.2 Internal relations*

The components of internal relations may be identified as follows:

- Product: Products and services represent the means by which every company may fulfill its mission and achieve economic, social, and environmental sustainability over time. One of the most important aspects in the value creation process consists precisely in the way a company's supply intersects with its strategy and with the ways in which it intends to achieve its objectives. Understanding whether the products and services supplied to the market are in line with the expectations and benefits requested by consumers is, therefore, one of the key aspects to support the growth of companies over time and ensure a constant alignment between strategic thinking, objectives, and customer satisfaction;

- Organizational model: It may be described in terms of human resources and in terms of operational systems. With reference to human resources, the implementation of personnel training or worker safety initiatives is effective methods to consolidate the satisfaction and retention of the workforce and, consequently, to ensure the future value and going concern basis of the

company itself. The organizational model, on the other hand, is a tool through which the organization may achieve its objectives and human resources are an integral part of it [52];

- Production: One of the most significant aspects of the corporate value creation process is the production size of an organization. Key activities for the strategic success of a company in the short, medium, and long term are concentrated within this area;

- Structure of costs: A company's structure of costs is a very significant aspect of its corporate model and this is so especially in situations of crisis, during which it systematically loses control over them and each resource becomes an additional opportunity to achieve balance. It is important to record KPIs relating to the structure of costs that may stand as anticipatory signs of imbalance, consistently with the characteristics of the business and its size.

## 7. Conclusions

The scenario that the pandemic will bequeath to companies will focus on their ability to create value, putting a strain on the effectiveness of their strategies and solidity of their business model. Although no regulatory requirement has been applied to all businesses (especially SMEs), the pandemic has highlighted the need to introduce new tools that may accompany a more traditional analysis of the financial statements. The expansion of the information basis presupposes the inclusion, when computing ratios, of tailor-made indicators in a company's reporting, set capable of effectively summarizing its going concern assumption, avoiding data duplication and redundancy, which could paradoxically hinder, instead of favoring, completeness and clarity of information. "Traditional" indicators, which mainly represent the company's tangible aspects, should be accompanied by some KPIs that complete the company's reporting process according to its distinctive characteristics and expertise, also completing the representation of components relating to relational, human, intellectual, and structural and risk capital.

The pandemic crisis, therefore, represents a testbed highlighting the importance of management control, of being equipped with a dashboard of financial and non-financial data, and knowing how to communicate them to stakeholders, showing whether the company is sound or otherwise and capable of coping with critical macro-and microeconomic issues that may have arisen as a result of the pandemic.

Communication on an ongoing basis will enable a significant information symmetry and paradoxically will allow companies to exploit "the lessons" learned in a period of generalized and structural difficulty even during the ordinary course of business, thereby becoming more capable of coping with potential critical issues that may arise and more importantly—doing it well in advance so as to avoid "suffering a new crisis" by trying to face and manage them on an ongoing basis, being aware of the fact that critical issues are an inevitable, contingent aspect that must be discussed openly so as to bring out problems, including potential problems, and identify corrective measures in due time based on a continuous improvement approach. This will allow companies, at least in potential terms, to avoid having to prepare weighty turnaround plans to get out of major crises, as the crisis will have by that time been broken down into its individual causal factors and the same may be considered, addressed and coped with more rationally and in a more systemic, but not one-sided and monopolizing, fashion.

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