# Corporate bankruptcies – missing or hiding?

Debora Revoltella

Chief Economist EIB

Dubrovnik Economics Conference, 2021

# Key messages

✓ So far, better than expected:

  ✓ Pro-active policy support: monetary, bank supervisory and fiscal policy, at the national and EU/EA

  ✓ Preserved credit provision to corporates, <u>avoiding a full-blown liquidity crisis</u>


✓ Risks are not over:

  • A "lost" 1 ½ year of profits leaves scares

  • The historical link GDP and insolvency is weakened, but remains, with country asymmetries

  • Firms and sectors specificities add to country challenges
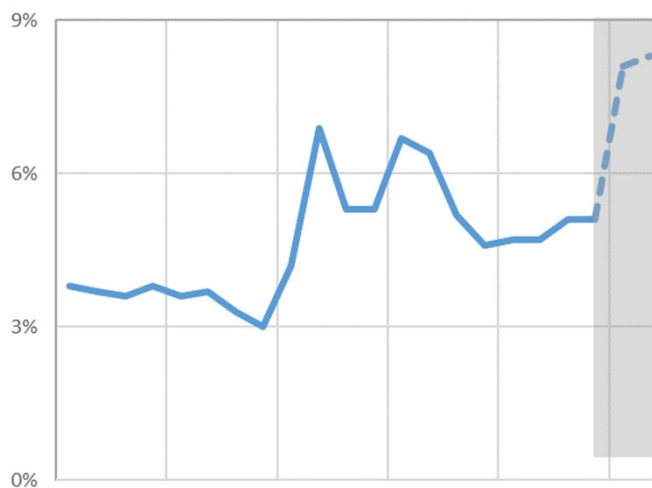

✓ Sovereigns the ultimate concern?
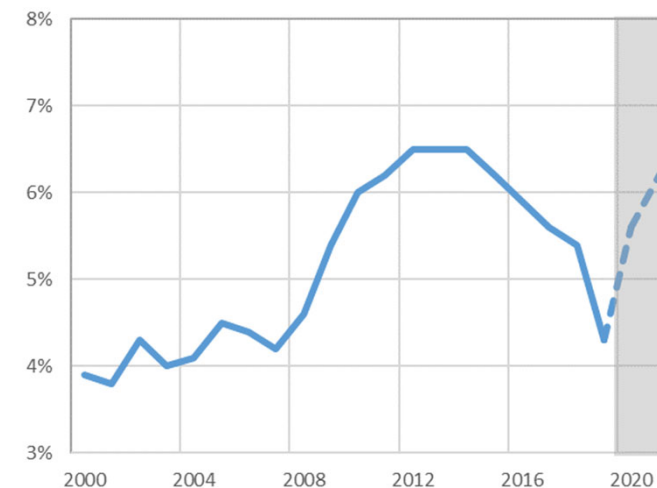
# Corporate risk indicators in an historical comparison

**Estimated proportion of corporates running out of cash over the period** *(%)*
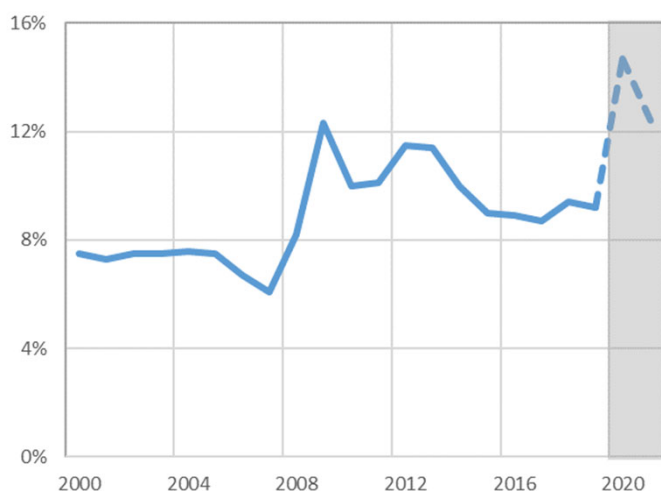
**Proportion of corporates with an Interest Rate Coverage Ratio below 1** *(%)*

**Distribution of estimated losses in proportion of the equity base** *(%)*



*Source*: ECON estimations based on ORBIS. *Note:* *the dashed line represents the projections.* see Maurin, Pal, and Revoltella (2021, forthcoming).

✓ From ORBIS firms level data and Eurostat hard data, we assess the impact of the crisis at sectorial level

✓ We simulate by sector/firm the evolution of profits using estimated elasticities and accounting for policy intervention

✓ (1) "Out of cash" more than in the GFC, (2) "IRC risk" similar increase then in the GFC, (3) "solvency risks" rising but starting from high equity base

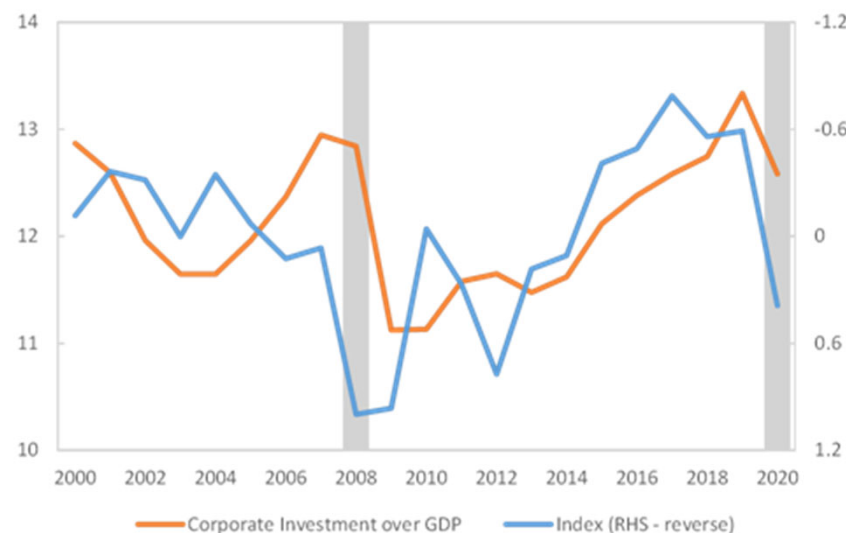European Investment Bank *The EU bank*

# Corporate Vulnerability Stringency Index and Corporate Investment

**EU Corporate Vulnerability Stringency index** *(Z-score, positive values more vulnerability)*
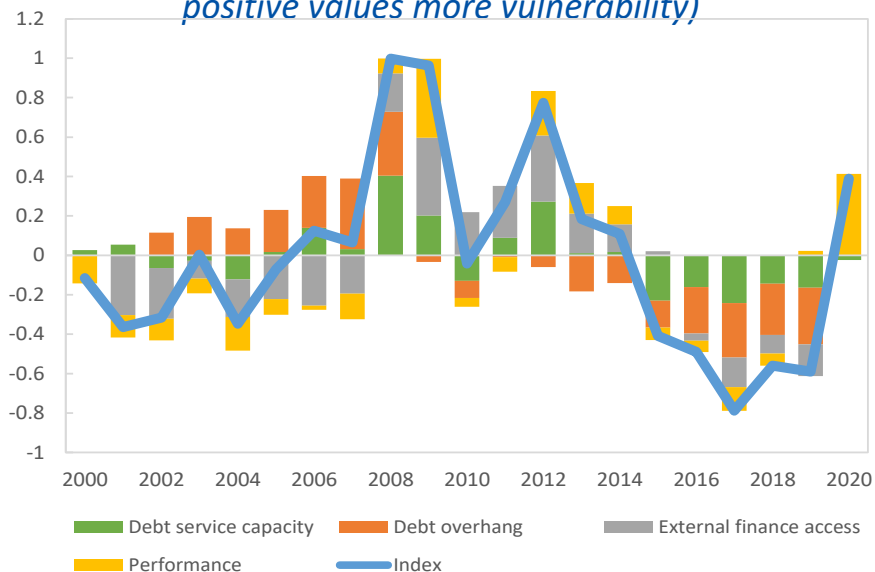


Source: ECON calculations based on Eurostat (Sectoral Accounts).

**Stringency Index and Investment ratio**



Source: ECON calculations based on Eurostat (Sectoral Accounts).

✓ EU corporate sector vulnerability index, based on consolidated corporate sector data. Between 2008-2014 the external finance access dimension was highly vulnerable. This time around performance is the constraining factor

✓ Correlating the corporate vulnerability index with investment ratios, we see a much lower effect of the crisis so far this time, but it is not over….

European Investment Bank *The EU bank*

# Bankruptcies reading blurred by policies measures but corporate exiting is countercyclical

**EU** *(available countries),* **corporate bankruptcy declarations** *(2015=100)*



*Source: EUROSTAT. Note: Compilation based on statistics sent by member states on a voluntary basis. Very imperfect coverage of EU economies. Last record 2021Q1.*

**Share of corporates ceasing to operate** *(%, EU)*
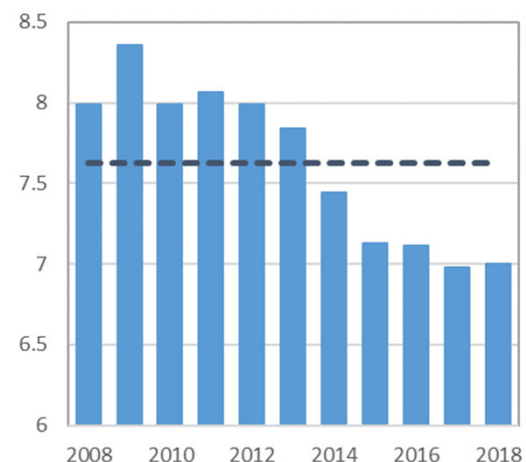


*Source: ECON calculations based on EUROSTAT. Note: 2018 partly estimated. The horizontal line reflects historical average over the period.*

✓ In many EU jurisdictions, obligation to fill for bankruptcy suspended for most of 2020, so that bankruptcy rates decline. But start of a rapid increase in the 2020H2.

✓ We project rate of corporate exit based on various measures of corporate profits growth:

  ✓ Countercyclical and lagging

  ✓ Response is stronger in smaller firms and in less efficient jurisdictions (liquidation time more than 2.5 years)

# Over time, corporate exiting is countercyclical but full pass-though takes time

**Exit rate of corporates projected on annual growth rates of various profit measures** *(cont. and lags)*

| | | Obs. | R2 (%) | Elasticity | | | | Long run elasticity (sum) | Obs. | R2 (%) | Elasticity | | | | Long run elasticity (sum) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | **All firms** | | | | | | | **Smaller** | | | | |
| | | | | Xt | Xt-1 | Xt-2 | Xt-3 | | | | Xt | Xt-1 | Xt-2 | Xt-3 | |
| **Net value added** | Whole EU | 28 (291 obs.) | 76.7 | -9.7 [0.02]** | -0.1 [0.02] | 0.3 [0.02] | 0.2 [0.01] | **-9.2** | 28 (287 obs.) | 71.7 | -14.6 [0.03]** | -1.6 [0.03] | -4.7 [0.03]* | 3.8 [0.02] | **-17** |
| | Longest | 8 (72 obs.) | 66.4 | -19.5 [0.04]** | -0.9 [0.03] | -0.9 [0.03] | 5.7 [0.03]* | **-15.6** | 8 (71 obs.) | 63.4 | -19.6 [0.07]** | -5.2 [0.06] | -13.5 [0.05]** | 6.6 [0.05] | **-31.7** |
| **Gross value added** | Whole EU | 28 (291 obs.) | 76.5 | -10.1 [0.02]** | -0.2 [0.02] | 1.4 [0.02] | -0.1 [0.02] | **-8.9** | 28 (287 obs.) | 71.1 | -14.5 [0.03]** | -1.7 [0.03] | -3 [0.03] | 3.9 [0.03] | **-15.3** |
| | Longest | 8 (72 obs.) | 66.7 | -22 [0.05]** | -1.9 [0.04] | -0.1 [0.04] | 7 [0.04]** | **-17** | 8 (71 obs.) | 62.2 | -20.4 [0.08]** | -6.6 [0.07] | -14.3 [0.06]** | 8.3 [0.06] | **-33** |

*Source: ECON calculations based on World Bank and Eurostat. **Note:** Cross section estimation of the **exit rate projected on contemporaneous and lagged changes – up to three years - in value added, net and gross**. Estimation based on annual data over 2008-2018 with country fixed effects. In the estimation "whole EU", data refer to all EU countries. In the estimation "longest", they refer to the group of countries with the least efficient judicial, those in which liquidation takes more than 2.5 years according to WB data.*
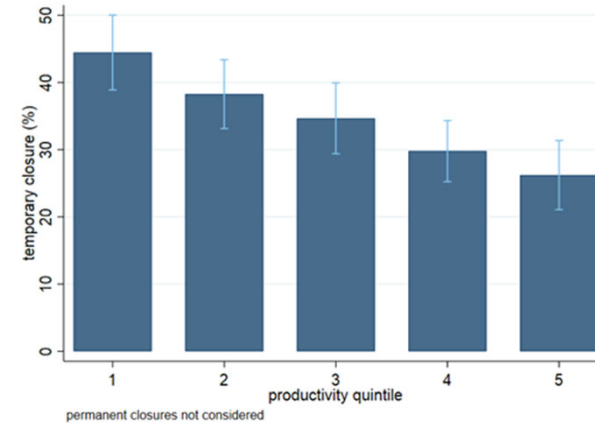
✓ Response is stronger in less efficient jurisdictions (those were time to liquidate is above 2.5 year).

✓ Response is also stronger for smaller firms (sole proprietorship).

✓ **These two channels are other source of asymmetries.**

# So far, lower productive companies most affected

**Firms that close permanently** *(%, EU)*
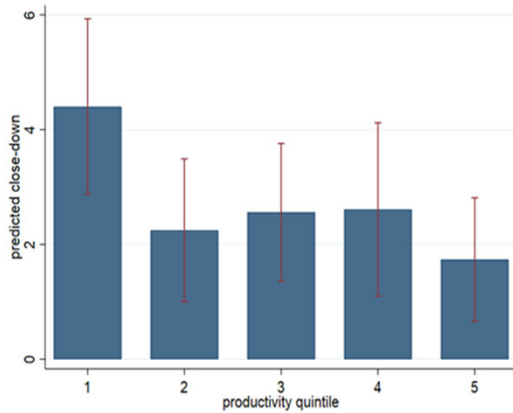
**Firms temporarily closed** *(%, EU)*





*Source:* ECON calculations based on ES.

✓ Enterprise survey data – Covid wave 1

✓ Evidence that less productive firms are more likely to close down (ca 2.8% of EU firms). Statistically significant results on the full sample with prod_sales, even when controlling for some firm characteristics such as size, age and exporter status.

✓ Results confirmed by more robust estimations, based on a larger sampler (ca 33% of EU firms).

# Sector and country asymmetries

**Risk indicators in level** *(% of firms)*



Source: Authors estimation.
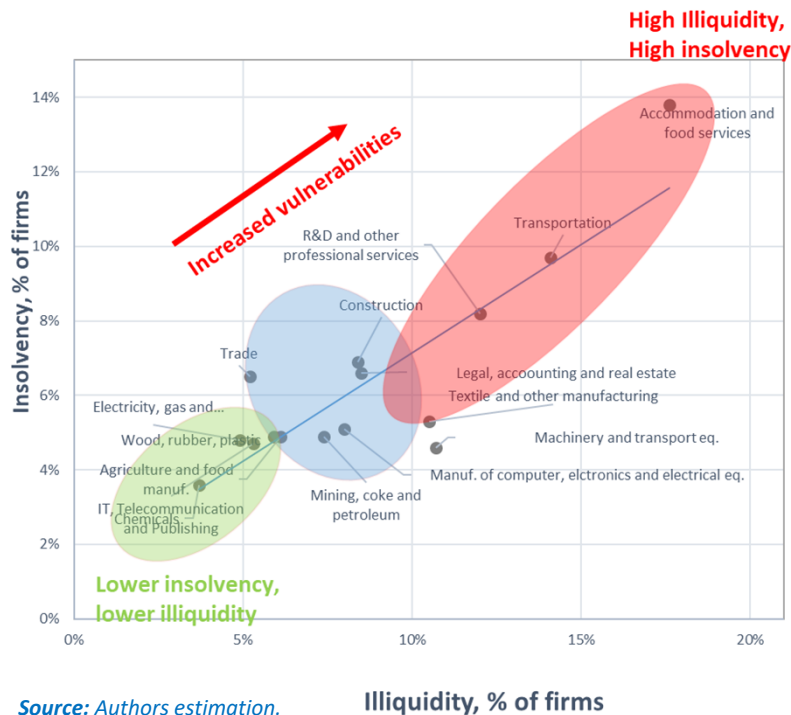
**Countries ranking in terms of sectorial hit**
*(number of sectors hit badly)*



Source: Authors' calculations based on Eurostat.
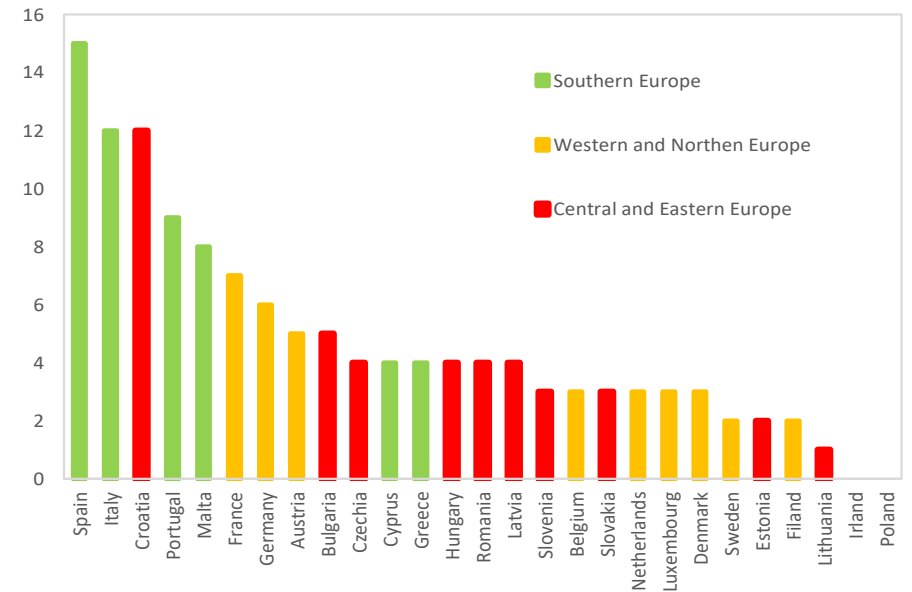
- ✓ Transport equipment, Accommodation and food service and Art and recreation - 9% of the EU economy - most hit.

- ✓ Sectors like Pharmaceuticals, Telecommunication, IT and Health, - 8% of the EU economy - much less.

- ✓ Weight on the economy is very asymmetric

# Public debt

**Public debt 2015, 2022 and 2022 net of today ECB and ESM/ESFS**
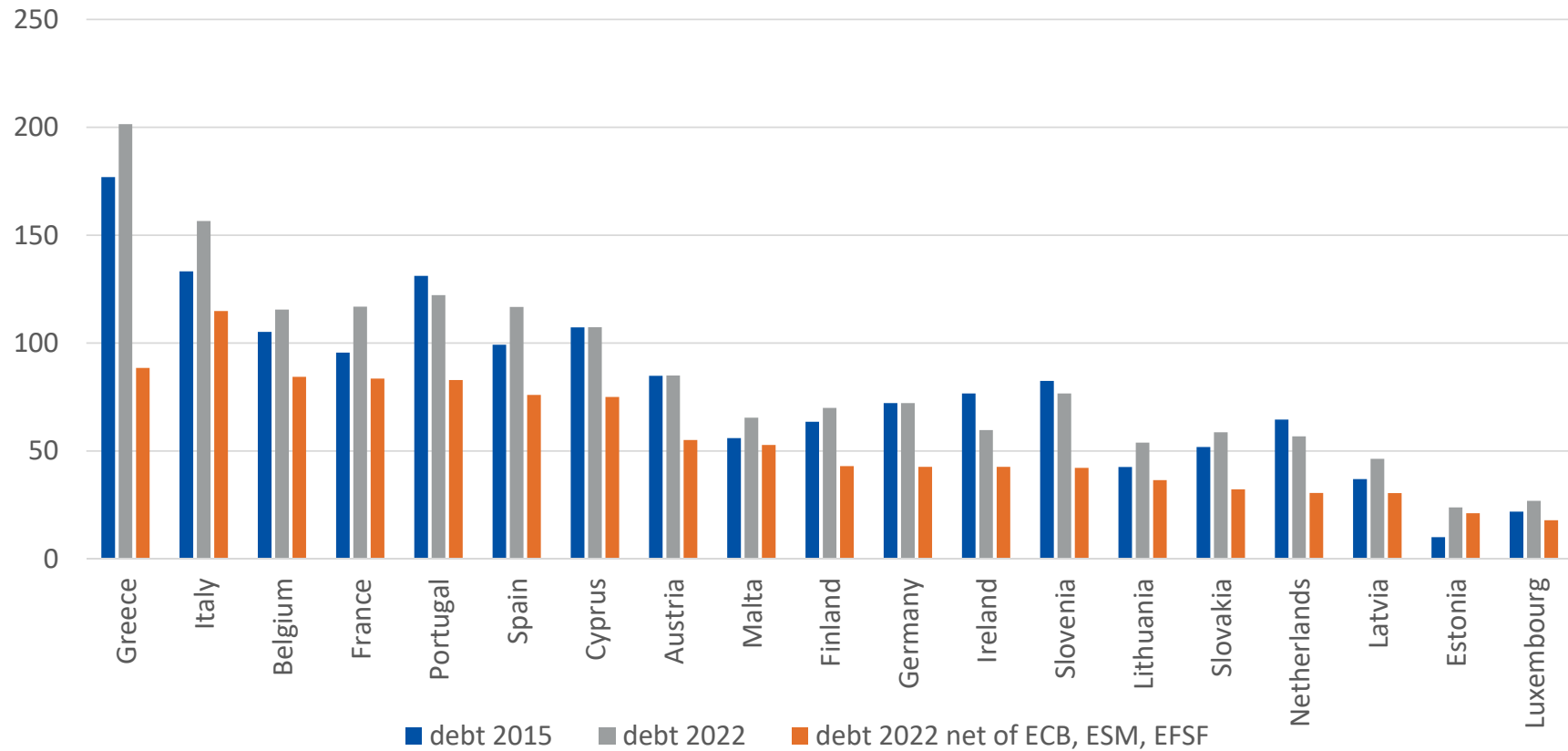


*Source:* Authors' calculations based on Eurostat.

# Policy messages

✓ With asymmetric fiscal capacities across EUMS, risks of an uneven recovery: **NGEU is key!**

   ✓ Public debt IS high!

   ✓ How to reintegrate fiscal rules?

   ✓ And what at the end of the PEPP? OMT?

✓ **Reducing policy uncertainty**. Still very much recovery dependent on policy support. Avoid a cliff effect when removing the policy support.

   ✓ And mind the social dialogue challenges…..(!)

✓ Corporates financing needs shifting towards equity type, especially as investors risk appetite likely to fade when needed most. Work on **CMU 2.0 also** very important!

# Annex 1 - Methodology to analyse corporate vulnerabilities

1. **We simulate profits in deviation from a pre-crisis normal at the firm level**
   - Estimating sector specific cost-to-sale elasticities (15 sectors considered)
   - Use hard data on change in turnover at the sector level to shock sales.
   - For 2020, we know the gap from turnover figures.
   - When simulating for 21, we calibrate the path based on the EC Winter 2021 forecast.
   - ➤ **Calibration of the policy support based on macro historical regularities**

2. **We build a corporate three risk indicators at the sector level**
   - Liquidity (cash position exhausted)
   - Default (IRC below 1)
   - Solvency (equity base wiped out)
   - ➤ **Sectors asymmetrically affected**

# Annex 2 – Corporate Vulnerability Stringency Index (Motivation/Methodology)

✓ We develop a Corporate Vulnerability Stringency Ind, at the country level (ECB *Financial Stability Review, November 2020 at the EA level)* in order to capture vulnerabilities in the NFCs sector.

✓ Four dimensions considered with 16 indicators : 1$^{st}$) Liquidity; 2$^{nd}$) External Finance access; 3$^{rd}$) Debt overhang; 4$^{th}$)Performance.

✓ Using Institutional sectoral accounts data from Eurostat, the index is an equally weighted average of the four dimensions above mentioned. Each dimension is compiled with several sub-dimensions which are standardize by getting a z-score, and then aggregated with a simple arithmetic.

✓ That said, positive (negative) values means higher (lower) vulnerability within the corporate sector.