PANORAMA
COMPANY INSOLVENCIES

A Coface economic publication

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Summary

Although the overall number of insolvencies continues to decline (-1.8% between September 2011 and August 2012), the summer of 2012 confirms the trend that began last Spring with an important growth in their cost (+17%) and a correlative increase in unemployment (+3.3%). The barometer presented in this panorama analyses this development, principally caused by the difficulties of larger French companies. A list is also given of the riskier sectors, those where risks are deteriorating and those which have been relatively spared.

This panorama includes an article which attempts to answer the following question: why does Germany have half the insolvencies of France? The sound financial health of its companies is an evident first explanation. However, German companies benefit from stable sources of external financing even during periods of financial turbulence, and from an insolvency law that encourages entrepreneurs to manage their company in a prudent manner at earlier stages.

But we should not think that German companies are totally sheltered: the increased number of insolvencies in the coming months is a scenario which cannot be excluded, because, from a statistical point of view, German insolvencies are very sensitive to the dynamics of exports.

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Barometer of insolvencies in France

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Warning on insolvencies: the rising cost of insolvencies is escalating, with a 17% increase between September 2011 and August 2012.

The situation observed in Spring 2012 is confirmed: in spite of a slight reduction in the number of insolvencies [(1)] during the first eight months of 2012 compared with the same period in 2011, the cost of the insolvencies continues to increase (+16.8%). The trend towards more large companies becoming insolvent is accelerating. The dampening of activity during the first semester and the climate of lack of confidence in economic agents is being reflected in a weakening of French business.

	January - August 2012	September 2011 - August 2012		
	Number	Number	Cost (Bn €)	Impact on employment
Insolvencies	38,297	59,165	4.49	188,956
Evolution	-1-8%	-1.8%	+16.8%	+3.3%

Source : Coface Services

Over the first eight months of the year, the number of insolvencies decreased (-1.8%). This trend, which is confirmed over the twelve month period (-1.8%) in relation to the same period of the previous year, should not mislead: since it only concerns sole proprietorships (*) whose number of insolvencies fell by 8.1% during the first eight months of the year, **while the number of insolvent companies has increased (+0.7%).**

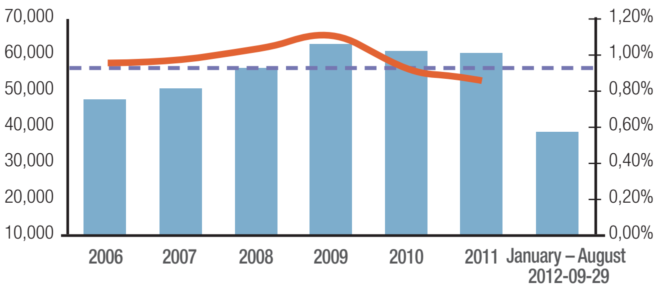
The disturbing trends observed in our panorama of Spring 2012 are worsening: **the cost [(1)] of the insolvencies continues to grow** at a rapid pace (+16.8% of debts). The receivership of the Doux Group (turnover of over 2 billion euros) weighs heavily on the suppliers and their outstanding amounts. As a share of GDP, the cost of insolvencies continues to increase slowly, currently representing 0.22% (against 0.21% at the beginning of the year).

Unemployment created by these insolvencies also continues to rise (+3.3%). The bankruptcy of large companies has led to the loss of a great number of jobs. Therefore, the liquidation of Neo Security (security and surveillance) and that of Mory Team (road transport) resulted in the loss of almost 9,000 jobs, that is 5% of the jobs lost due to all insolvencies in the last twelve months.

The evolution of insolvencies in France varies according to the size of the companies involved. Hence, micro-enterprises and very small companies have shown a declining number of insolvencies (respectively -1.9% and -3.9%). **In contrast, this trend is the opposite where large SMEs are concerned (permanent staff above 20 employees)** with an increase in insolvencies of 5.3%.

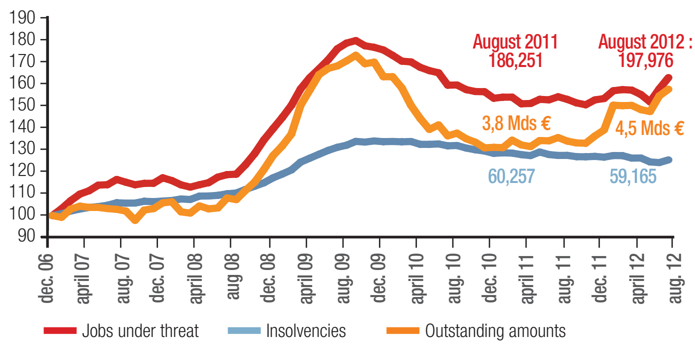
Moreover, **the situation continues to worsen for intermediate-sized companies [(1)]** and large companies. During the first eight months of 2012, the number of insolvencies amongst this type of company grew by 34.2%. Large and established companies, such as Marie Brizard (58 years in existence in the area of alcoholic drinks) or Doux SA (52 years in poultry production) were placed in receivership, respectively in June and July 2012.

Graph 1:
Evolution of the number of insolvencies and associated rate



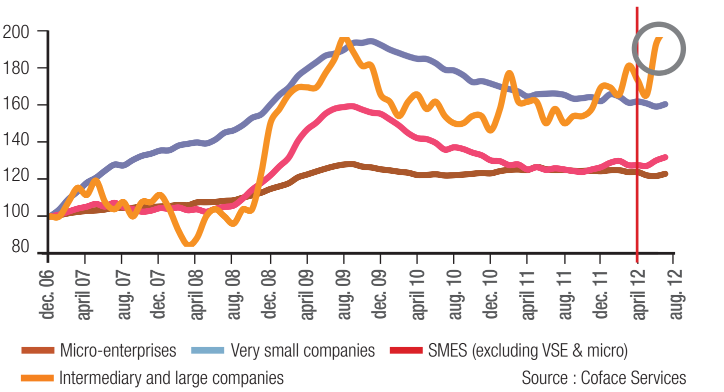
Source: Coface Services

Graph 2:
Evolution of the insolvencies and their costs (base100: December 2006)



Source : Coface Services

Graph 3:
Evolution of the insolvencies according to their profile (base100: December 2006)



Source : Coface Services

(1) See Glossary page 3

Analysis by sectors

The majority of insolvencies in France continue to be concentrated in the construction and service sectors. The distribution sector still remains at risk. The automotive and transport industries continue to deteriorate as observed in spring.

Activity sectors	Weight***	Evolution **	Number**	Insolvency rate
Construction	33%	-3.0%	19,321	0.7%
Services to private customers	17%	-0.7%	9,871	1.4%
Other services*	15%	-3.7%	8,951	0.4%
Distribution	9%	-3.8%	5,400	1.6%
Automotive and Transport	7%	6.7%	3,898	2.0%
Agribusiness	7%	0.3%	4,285	0.5%
Textile - clothing	4%	5.8%	2,183	1.2%
Electronics and IT - Telecom	3%	-0.2%	1,758	1.4%
Paper - wood	3%	-8.2%	1,788	0.5%
Metals	2%	-10.8%	1,065	1.4%
Chemical	1%	8.6%	645	1.1%
Total	100%	-1.8%	59,165	0.7%

Source : Coface Services
* Services dedicated to local companies and authorities
** Over a 12 month period, from September 2011 to August 2012
*** Weights: Number of insolvencies in the sector / number of total insolvencies

Sectors at risk

- **Construction** contains a large proportion of insolvencies in France, with a little under 20,000 bankruptcies from September 2011 to August 2012. This sector continues to suffer from the present economic conditions, although the number of insolvencies is falling significantly (-3%). Construction start-ups are currently down by 10% and recovery is not expected for at least another year. Public works companies should be penalised by the suspension of numerous public projects.
- **Services** continue to represent an important proportion of insolvencies. However, a downward trend is observed. Therefore, services to private customers have decreased by 0.7% (essentially concerning beverage companies and hairdressing saloons) and services to companies and local authorities by 3.7%. In spite of this trend, the sector of services to private customers continues to show a high insolvency rate (1.4%), especially in the catering area.
- **Retail** (insolvency rate of 1.6%) has shown a declining number of insolvencies (-3.8%), because this sector is increasingly concentrated. Non-current consumer product retail, such as jewellery, toys and music continue to face sluggish internal demand.
- **The automotive industry and transport** suffer from the difficulties of the major French construction companies and from the continued high prices of oil. The number of insolvencies has therefore increased by 6.7%, and the insolvency rate of the sector continues to be very high (2%)..

Sectors where risks are deteriorating

- **Chemical,** a sector which has little representativeness in terms of insolvencies, deteriorated in 2012 (+8.6% of additional insolvencies). This increase is essentially concentrated in the wholesale and retail trade of perfumes/ cosmetics and pharmaceutical products (50% of insolvencies in this sector) with 33% of additional insolvencies.
- **The textile-clothing sector** is one of the very few sectors which continues to show an increase in the number of insolvencies (+5.8%). Clothing accounts for 68% of the insolvencies in the sector, so it is clearly experiencing difficulties. A fall in sales of women's ready-to-wear clothing was observed during the first semester, due to the unprofitable summer sales in the current economic environment which is unfavourable to the purchase of clothing, with the weather also having played a role in this respect.

Sectors which have been relatively spared

- **Agribusiness** continues to be stable, in terms of insolvencies, compared to the beginning of the year. This sector is currently being spared since the purchase of food products continues to be a priority for households, which tends to preserve retail trade. According to Coface analysts, the increased price of commodities should, nevertheless, affect the margins of the animal feed industry.
- **Paper-wood**, appears to be a safer sector, with a considerable decline in the number of insolvencies (-8.2%), as well as a fairly low insolvency rate. This sector, under strong competition from China, is going to be concentrated as a result of the decreased consumption of paper, and is increasingly turning to the recycling of used paper.
- The most significant reduction in the number of insolvencies concerns the **metals** sector, which continues to be robust in 2012, due to an economic and financial restructuring of the sector and reduction in overcapacity, enabling the recovery in margins. This sector may face difficulties in 2013, since its main outlets are currently experiencing hardship (automobiles, construction and public works).
- **Electronics and IT-telecommunications** continue to benefit from an important consumption of new technology products. The IT service industry, which accounts for two thirds of the insolvencies in the sector, appears, according to the experience of Coface, to be solid, notably thanks to outsourcing in Asia and development driven by the external growth of other European countries.

Glossary:

- Insolvency: legal insolvency, economic restructuring or liquidation, both through court order.
- Insolvency rate: number of insolvencies of the sector / number of companies in this sector.
- Sole proprietorship: enterprises managed by a single person (INSEE legal category 11 to 19).
- A Small and Medium-sized Enterprise (SME), according to INSEE, employs less than 250 people and has an annual turnover below 50 million euros or a total balance sheet not above 43 million euros. This term includes Very Small Enterprises, with less than 20 employees (which also covers micro-enterprises with less than 10 employees).
- An Intermediate-sized Enterprise has 250 to 4 999 employees and either a turnover not above 1.5 billion euros, or a balance sheet not above 2 billion euros.
- A Large Enterprise is an enterprise which has over 5 000 employees.
- Cost: accumulated outstanding supplier amounts of each insolvent enterprise.

Why are there less corporate insolvencies in Germany?

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Since the beginning of the 1990's, Germany has shown a lower number of insolvencies than France. This article aims to present the main factors which explain, in our opinion, the performance of Germany. Three main factors are identified: the sound financial health of German companies, sustained by high profitability; stable financing sources, even during periods of financial turbulence; a different insolvency law, encouraging entrepreneurs towards a more prudent management of the enterprise at earlier stages. In view of all these advantages, are German companies therefore immunised against the current fall in external demand, notably of European origin? Econometric analysis reveals that the evolution of insolvencies in Germany is very elastic to the evolution of exports and investment. Now that exports showed signs of weakness over this summer and investment contracted during the second quarter, a return to increased insolvencies is not, therefore, a scenario to be excluded.

The statements, at the beginning of the month of September, of the chairman of the Federation of German Industry, Axel Rückert [(2)], encouraging France to draw inspiration from the German social model, rekindled the debate around the divergent strategies of development of the two first European economies. While the respective virtues and limits of the two models may be discussed, in contrast, there is one particular finding that stands out between the countries: Germany shows a lower number of corporate insolvencies than France (see box).

Less corporate insolvencies in Germany than in France

In 2011, Germany recorded 30 099 corporate insolvencies [(3)] against 50 485 [(4)] for France, which is a difference of almost 40% over the entire year (*table 1*). This differential between the two countries is not due to an exceptional decline of insolvencies in Germany for 2011 (-5.9% compared with -0.6% in France in 2010), but rather the reflection of a structural trend. In fact, since the early 1990's, Germany has shown a lower annual number of insolvencies than France. While the figures converged in the early years of the twenty-first century (downwards for France and upwards for Germany), since 2005 these figures have embarked on a diametrically opposite path: in Germany, the insolvencies are close to resuming their level before the bursting of the dot.com bubble (close to 30,000 annual openings of court proceedings), while they increased sharply in France with the 2008-2009 crisis to stabilise around the threshold of 50,000 openings of procedures since 2010 (*graph 1, page 5*).

The higher number of insolvencies in France is not compensated by a more important stock of companies. In spite of the law on self employed workers of 2009, which has taken the French to the rank of European leaders of companies creation, their total number remains slightly higher in Germany with 3.8 million companies in 2011, against 3.5 million in France. By combining a more important stock of companies and a more moderate number of insolvencies, Germany thus shows a considerably lower bankruptcy rate of its companies than France, of 0.78% against 1.43% in 2011.

Moreover, this ratio, in contrast to that of the Hexagon, has shown a downward trend since the beginning of the twenty-first century, with insolvencies accounting for 1.60% of the total number of companies in 2002 (*graph 2, page 5*).

Insolvencies in France and Germany: are we referring to the same thing?

In France, as in Germany, an company is in a situation of insolvency or bankruptcy once court proceedings are opened against it.

In France, these proceedings intervene when the company is at a stage of suspension of payments, which implies that it is not capable of meeting its current liabilities with its available assets. The procedure may either lead to a company reorganisation, or to its liquidation. Furthermore, the safeguard procedure may be opened before the stage of suspension of payments of the company.

In Germany, the causes of the opening of the proceedings are illiquidity (*Zahlungsunfähigkeit*), that is, the situation where the debtor is incapable of meeting its outstanding payments; over-indebtedness (*Überschuldung*), when the assets are insufficient to cover the debts; imminent incapacity to meet liabilities (*drohende Zahlungsunfähigkeit*) when it is likely that the debtors will be incapable of meeting debt repayments in the future.

In these two countries, the court proceedings may lead to the reorganisation of the company or to its liquidation.

Another difference between the two countries is that in France commercial courts, which have jurisdiction for insolvencies, are headed by lay judges, whereas in Germany the local courts with this jurisdiction are headed by professional judges.

Table 1 :
Enterprises and insolvencies in France and Germany in 2011

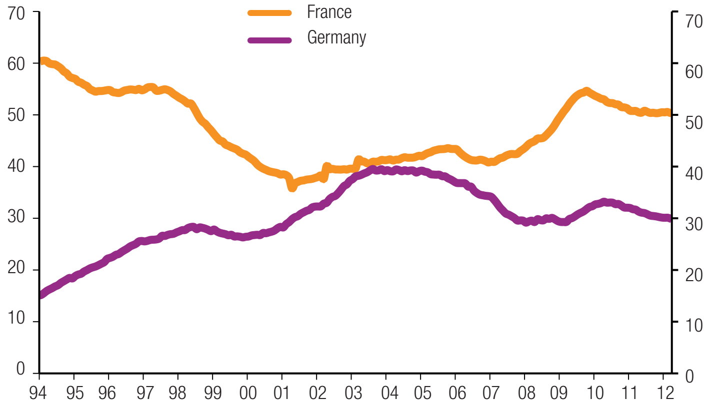
	Germany		France	
	2011	n/n-1	2011	n/n-1
Number of companies (x)	3,853,632	+0.8%	3,519 467	+2.8%
Creations	437,400	-3.9%	549,805	-11.6%
Closures	391,001	-0.1%	307,128	+3.5%
Insolvencies (y)	30,099	-5.9%	50,485	-0.6%
Cost (Mds €)	20	-24.8%	14.3	+9.6%
Rate (x/y)	0.78%	-6.7%	1.43%	-3.4%

Sources: Destatis, INSEE, Coface Services

(2) Axel Rückert, La France a tout à gagner à s'inspirer des bonnes pratiques sociales de son voisin d'outre-Rhin, Les Echos, Paris, 9 September 2012, link URL: *http://lecercle.lesechos.fr/economie-societe/politique-eco-conjoncture/politique-economique/221153722/france-a-a-gagner-a-sinspi*
(3) In order to be able to compare the two countries, an «enterprise» has been defined as all non-financial companies with commercial activity, including personal affairs.
(4) Source: INSEE

Graph 1:

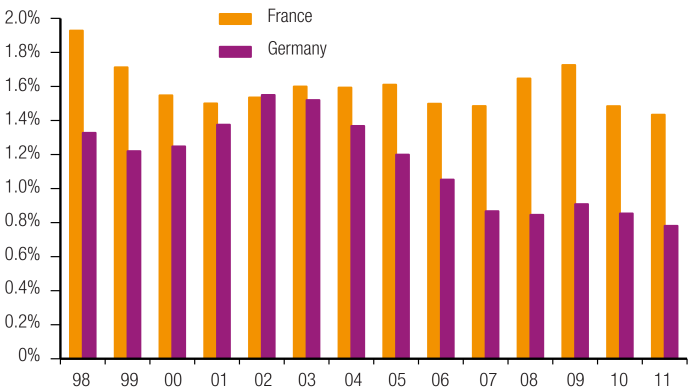
Number of corporate insolvencies in France and Germany (1994-2012), moving total over the last 12 months (thousand),



Sources : INSEE, Destatis

Graph 2:

Insolvency rate France and Germany (1998-2011)



Sources : INSEE, Destatis, Coface Services, Datastream

Moreover, corporate insolvencies are more expensive in Germany. Indeed, in 2011, their total cost reached 20 billion euros against 14.3 billion in France. Furthermore, the average cost of an insolvency has, since 2006, been three times higher in Germany, standing at 700,000 constant euros, against 200 000 in France. However, this finding should be placed in context. In relative terms, the differential between the two countries is considerably less marked: in fact, the cost of the insolvencies represents 0.8% of GDP in France against 1.1% in Germany *(graph 3)*. In addition, while the average cost per insolvency is lower in France, this is also because French companies are on average smaller than their German counterparts: in 2007, companies with 10 to 249 employees represented 17.8% of the total companies in Germany, against only 6% in France *(table 2)*.

The pervasiveness of medium sized companies in Germany (the famous *Mittelstand*, see box) is, in our opinion, at the very heart of the opposing differential of France and Germany in terms of insolvencies: on average larger than their French counterparts, German companies are less exposed to the risk of default, but when this does materialise, its cost is higher. However, in addition to the differences in the composition of the business structure of the two countries, we identify three principle factors which contribute to explain why Germany shows less corporate insolvencies than France: the divergence of objectives between the German and French insolvency laws, the higher profitability of German companies, and the stability of the external financing sources in Germany.

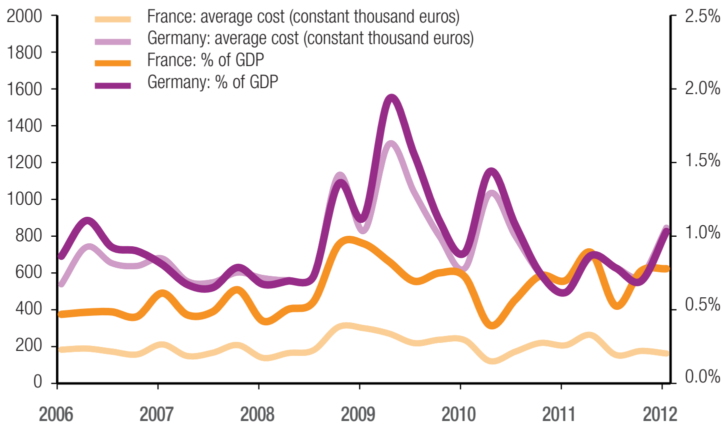
What is the definition of Mittelstand?

Mittelstand is a concept which must be handled with caution, insofar as it is specific to Germany, as recalled by Markus Gabel (*«Also, if we are simply speaking of Micro enterprises and SME, Germany, with the Mittelstand also combines sociological and psychological aspects»*) or Ludwig Erhard (*«The Mittelstand can hardly be measured merely in material terms, because it is strongly embedded with a state of spirit and a specific attitude which is expressed in the socio-political process»*). Furthermore, the material definition is difficult and varies according to the sources. The Bonn Mittelstand Institute (IfM) and KfW thus define it as the group of Companies with 0 to 499 employees and a turnover below 50 million euros. We agree with the definition given by the European Commission (Regulation 96/280/EC): a permanent staff of 10 to 249 employees, a turnover of 10 to 50 million euros (or a balance sheet between 10 and 43 million euros) and less than 25% of equity or voting rights controlled by a third party undertaking.

Markus Gabel, «Financement et vieillissement: le mittelstand en mutation», Regards sur l'économie allemande [online], 69 | 2004, placed online on 27 January 2009, Consulted on 14 September 2012. URL: http://rea.revues.org/index3313.html

Graph 3:

Cost of the insolvencies in France and Germany (2006-2012)



Sources : INSEE, Destatis, Coface Services, Datastream

Table 2:

Demographics of the companies in France and Germany (data of 2007)

Profile	Germany	France
Micro (0-9 employees)	**81.4%**	**93.9%**
Very Small Enterprises	10 - 49 employees	10 - 19 employees
	15%	**3,6%**
SME (excluding VSE and Micro)	50 - 249 employees	20 - 249 employees
	2.8%	**2.4%**
ETI + GE	**0.7%**	**0.2%**

Sources : Destatis, INSEE

A different approach of the insolvency law

The differences regarding the insolvency proceedings pursued in France and Germany constitute, in our opinion, a primary factor explaining the lower number of corporate insolvencies in Germany. Traditionally, insolvency law has always sought to accommodate two objectives which are, nevertheless, difficult to reconcile, namely that of maintaining the activity of the insolvent company and that of protecting its creditors. However, this past decade has witnessed a growing divergence between Germany and the rest of Europe regarding the goals pursued by the legal framework for corporate insolvencies. The combination of a growing economic slowdown and high unemployment has influenced most of the legislators (like France) to give priority to the survival of the company over the interests of its creditors, essentially for the purpose of safeguarding employment. In Germany, in contrast, the legal system for insolvencies has remained very favourable to the creditors.

While in France the judge is capable of effectively controlling the proceedings and takes himself the final decision regarding the future of the debtor, the judge, in Germany, merely and mainly arbitrates the proceedings, after which it is the creditors committee – and not the judge – which decides on the restructuring or liquidation of the debtor enterprise. Moreover, before the ESUG amendment (5) (enforced on 1 March 2012) to German insolvency law (*Insolvenzordnung/InsO*), the opening of insolvency proceedings, most of the time, led to the disqualification of the enterprise CEO and his/her replacement by an insolvency administrator appointed by the court (with the judge being distrustful of the good faith and capacity of the debtor to restore its credit). In France, in contrast, the company CEO remains in charge of affairs, assisted by an administrator during the safeguard or reorganisation proceedings.

Until March 2012, German insolvency law far more unfavourable to the insolvent company than its French counterpart, therefore encouraged a more prudent management of the company. The recent ESUG amendment to the law on insolvency, which marks a major turning point in German insolvency law, adds further fuel to this encouragement to act at earlier stages. Without placing in question the weight of the creditors in insolvency proceedings, the amendment effectively seeks to favour the restructuring of companies rather than their liquidation, by facilitating the use of self-administration by the debtor (the enterprise CEO is no longer disqualified by the court). Since March 2012, the local courts (*Amtsgericht*) are actually forced to appoint a provisional creditors' committee upon the opening of the proceedings and until its effective implementation if certain conditions are met (6). The provisional committee might either suggest the appointment of the insolvency administrator to the court, or support the self-administration of the company requested by its executive director. When the debtor requests self-administration with the support of an expert's opinion and the committee, the court cannot object (as it had been the case before), because it is presumed that self-administration does not create any prejudicial effects on the creditors. During a maximum period of three months, the debtor may then, in collaboration with the creditors and under the control of the court, prepare a restructuring plan which will be voted upon, eventually, as an insolvency plan. During this period, the creditors cannot initiate enforcement proceedings, due to the «protection shield» principle (*Schutzschirm*).

These measures contained in the ESUG amendment should encourage the insolvent debtor to intervene at earlier stages in court to initiate the insolvency proceedings, in order to enhance its chances of restructuring relative to the creditors.

Ultimately, the ESUG amendment might, therefore, significantly swell the number of insolvencies in Germany.

However, it remains that the incentive created by the assertiveness of German insolvency law regarding the insolvent company probably constitutes a factor which might explain the lower number of insolvencies in Germany. But, the financial situation of the companies might also constitute an equally important explanatory factor.

Financially solid companies

Table 3:
Financial situation of companies in France and Germany (2000-2011)

	Germany		France	
	2000	**2011**	**2000**	**2011**
Profit (% of GDP)	7,0%	10,3%	8,7%	6,8%
Self-funding rate	60%	107%	85%	67%
Debts (% of GDP)	67%	77%	83%	103%
Gross profitability (EBITDA/Value Added)	44%	49%	31%	30%

Sources: Destatis, INSEE, Eurostat, Datastream

German companies are indeed more financially solid than their French counterparts (*table 3*). This good financial health is reflected in the substantial portion of internal resources in the structure of their financing. According to a recent study of the Bundesbank (7), self-funding effectively represented over 65% of the capital raised by German companies between 1991 and 2010. Furthermore, its main components recorded sustained progression over this period. Thus, amortisation (85% of the internal financing over the period) soared by over 60% after the reunification (8), from 120 billion euros in 1991 to 190 billion in 2010. Provisions followed the same trend: according to the Bank of France (9), provisions currently represent 21.7% of the liabilities of German companies of the manufacturing sector, compared with merely 6.7% for their French counterparts. Finally, retained earnings (almost 15% of internal financing between 1991 and 2010) have also recorded sustained growth, with the tax reform of 2000 having encouraged the hoarding of profit rather than its distribution.

Currently, in total, the gross disposable savings of German companies fully recovers their investment expenditure. The rate of self-funding actually reached 108% in the first semester of 2012 (against 59% in the third semester of 2000), that is, the same level as before the bankruptcy of the Lehman Brothers in September 2008. The growth of self-funding capacity has

(5) "Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen" (law aimed at facilitating enterprise restructuring).

(6) The enterprise should meet at least two of the following criteria: a total balance sheet of at least 4.84 million euros, turnover of at least 9.68 million euros during the 12 months preceding the closing of the accounts, and an average of at least 50 employees over the year.

(7) Deutsche Bundesbank, Long-term developments in corporate financing in Germany – evidence based on the financial accounts, Deutsche Bundesbank, Monthly Report January 2012, Frankfurt.

(8) Since 2009, new accounting guidelines permitting greater depreciation have been in effect in Germany.

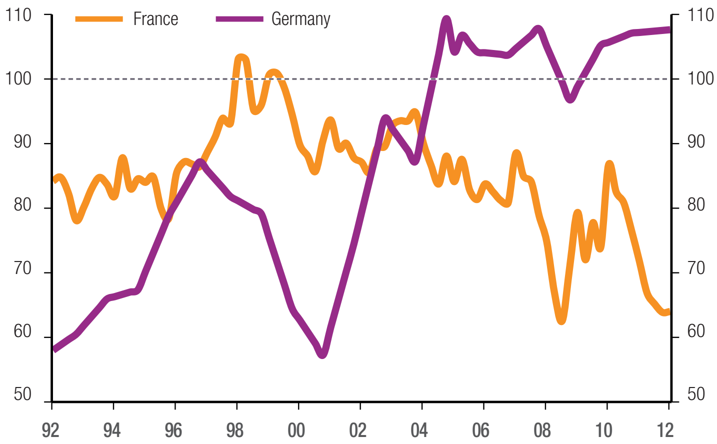
(9) Observatoire des enterprises, Les PME en Europe: les disparités entre pays and secteurs sont plus fortes en 2010 qu'avant la crise, Bulletin N.188 July 2012, Banque de France, Paris.

dampened dependence on external financing, although corporate debt has remained stable since the early years of the twenty-first century: where it should represent 77% of GDP by the end of 2012, against 67% at the end of 2000.

In France, these trends have followed an opposite path since the beginning of the twenty-first century. Admittedly, companies have improved the structure of their balance sheets since the end of the 1990's (reinforcement of equity capital), but their self-funding capacity has also deteriorated significantly during the same period: having stood at over 100% in 1999, the self-funding rate of French companies had fallen to 64% by the first semester of 2012, the deterioration reached at the height of the crisis of 2008-2009. This growing funding requirement is reflected in the use of bank credit and increased indebtedness of companies. Therefore, debt derived from bank credit to non-financial companies had soared from 32% of GDP in 2000 to 45% by the end of 2011, while the total debt of companies increased from 83% to 103% of GDP over the same period (*graphs 4 and 5*).

Graph 4:

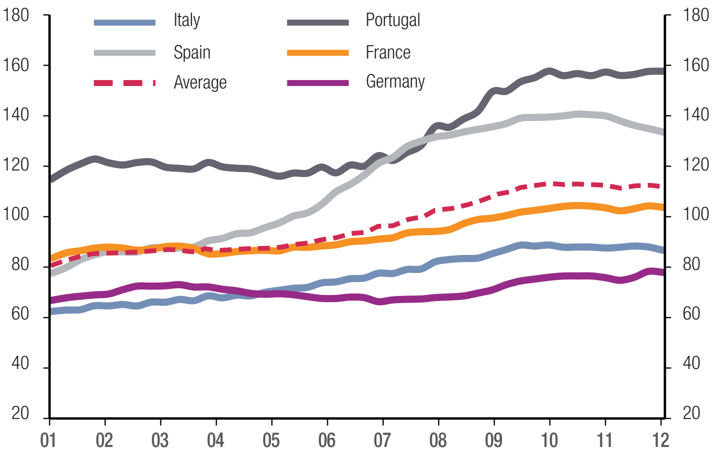
Rate of self-funding of non-financial companies in Germany and France (1992-2012) (gross disposable savings/GFCF, %)



Sources : INSEE, Buba, Datastream

Graph 5:

Corporate debt in the main European economies (2000-2012), % of GDP

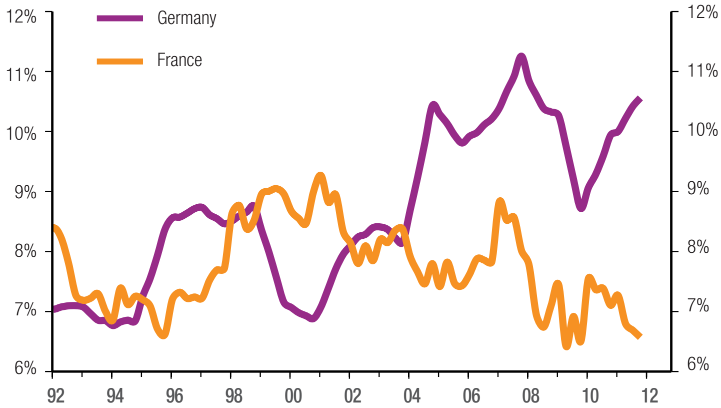


Source : ECB

This differential between Germany and France is explained by the higher level of profitability of companies in Germany. By the fourth quarter of 2011, their profit after taxes, interest and dividends represented 11% of German GDP against 6% in 2000. During the same period, the profitability of French companies deteriorated: from 9% of GDP in 2000, profit levels had fallen to 6.5% by the end of 2011 (*graph 6*).

Graph 6:

Corporate profit in France and Germany (1992-2012) after taxes, interest and dividends, % of GDP

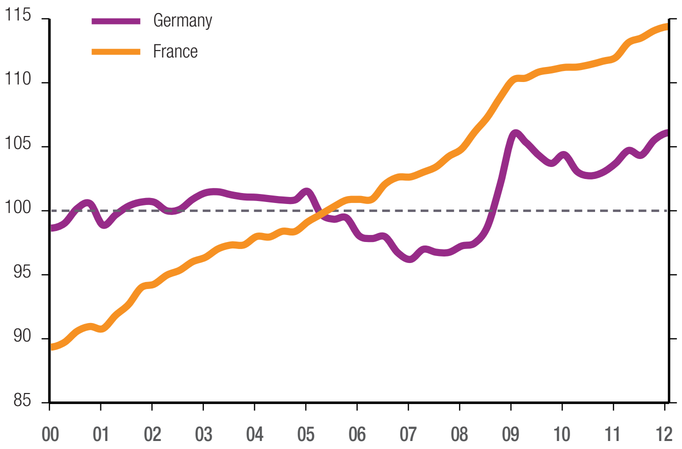


Sources : Eurostat, Natixis

This upward trend observed in Germany cannot be disassociated from the substantial competitive gains recorded by the companies in the aftermath of the 2000-2003 crisis. Following the bursting of the dot.com bubble in 2000, the governments of Chancellor Gerhard Schröder (1998-2005) decided to refocus the German growth model on industry. The pension plans and health system were thoroughly reformed, moderation on salary growth was imposed as of 2003, while the Hartz laws (2003-2005) worked towards increasing the flexibility of the labour market and reducing the amount of social security contributions payable by companies. At the same time, the adherence in 2004 of various countries of Central and Eastern Europe to the European Union encouraged German producers to reinvest their surplus savings in outsourcing part of their value chain in the Czech Republic, Slovakia or Poland. They also took advantage of the low cost of qualified labour in Central Europe, while continuing to keep a substantial part of their production capacity in Germany.

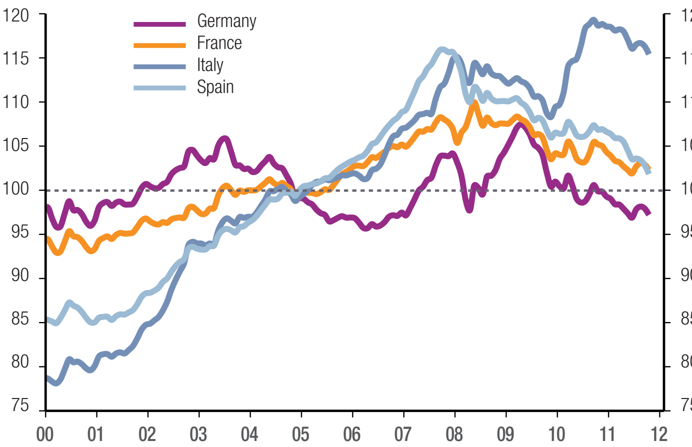
Overall, the strategy pursued in 2003 contributed to the marked reduction in the cost of labour (*graph 7, page 8*), which was reflected in the cost competitiveness of companies (*graph 8, page 8*). Since then, the nature of union bargaining in Germany has enabled the country to keep to this policy of redistribution of valued added. In contrast to France, the negotiations between employers and employees have effectively tended to favour employment over wages, based on the idea developed by the Bundesbank that household consumption is more elastic to jobs than to wages. Therefore, we find that in Germany, the nominal wage adjusts to variations of employment, which is not the case in France. This adjustment of the labour market through prices tends to restrain the increase of unitary wage costs, which contributes to preserving enterprise profitability, especially during times of crisis.

Graph 7:
Unitary wage cost in Germany and France, 100 = 2005



Sources : INSEE, Destatis, Datastream

Graph 8:
Real effective exchange rate (10) of unitary wage costs (2000-2012), 100 = 2005



Sources : IMF Financial Statistics, Datastream

However, while the adjustment of production costs has been a primary factor in increased profitability in Germany, it is also explained by the substantial effort to move upmarket carried out by companies during the twenty-first century. The priority given to capital over wages in the sharing of value added has indeed contributed to the growth of the gross profitability of companies (EBITDA / value added), from 44% in 2000 to over 52% in 2007, while it has remained stable in France, around 30%. This improvement of operating margins has particularly benefitted investment, which, in Germany, represented 33% of GDP between 2000 and 2010, against merely 19% in France (Eurostat, 2011). This robustness of investment, combined with the sustained progression of the share of capital goods and R&D in the total investment of companies, has enabled production to move upmarket. These gains in terms of product competitiveness currently confer two major advantages to German companies. The first refers to the low price elasticity of high quality German products which enables producers to add the increased production costs to sale prices (price-makers). The second is the solid export position, and increasingly towards the emerging economies (as a proportion of GDP, Germany exports three times as many goods to the BRICs as France).

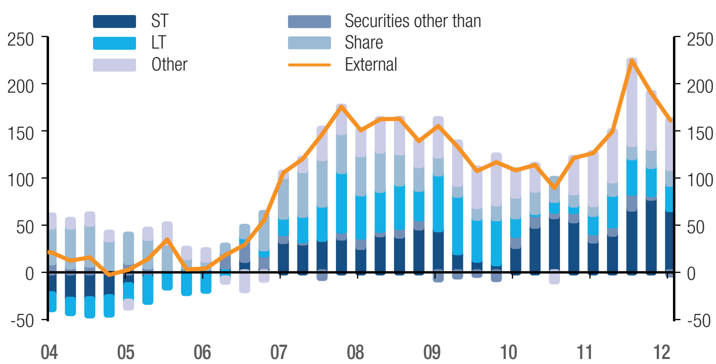
Therefore, the redirection of the German growth model has launched it into a virtuous cycle, based on the financial solidity of the companies. German producers have become price makers, which has enhanced their profitability, self-funding capacity and investment. In contrast, the compression of the profit margins observed over the last ten years in France, combined with the willingness of companies to strengthen their equity capital, has burdened the upmarket movement of their production, constraining the reflection of higher production costs on sales prices. Admittedly, French companies are currently well capitalised, but the downswing of their profitability has increased their dependence on external funding sources, notably bank credit. This trend enhances their vulnerability during periods of financial crisis, when external funding becomes unstable, as was the case in 2008-2009. Surprisingly, German companies did not have to face too much volatility of their external financing. This stability certainly contributed to some extent to the lower exposure to risk of default.

The crisis has highlighted the stability of the external funding of German companies

The external funding of companies (covering the raising of loans, issue of securities, trade credit and technical insurance provisions) in Germany stood up well to the financial turbulence which followed the bankruptcy of Lehman Brothers [11].
Between the first tensions observed in the interbank market in August 2007 and the peak of the crisis in 2009, the total volume of external funding fell by 30% in Germany, against almost 90% in France. Moreover, the funding structure has not changed profoundly in Germany, which has not been the case in France *(graphs 9 et 10 page 9)*.

There has been, in fact, a net decline of loans to French companies following the bankruptcy of Lehman Brothers, particularly short term loans. This trend has been combined with a fairly severe contraction of trade credit, a reflection in the reciprocal lack of confidence of companies in a particularly uncertain context. The tightening of these loans has been compensated especially by the increased issue of securities, notably debt securities. However, this replacement of interim funding by market financing has probably affected French SMEs and micro-enterprises, whose size does not allow them to issue debt on markets.

Graphe 9:
External funding of companies in Germany (2004-2012), moving total over the last four quarters, Billion euros

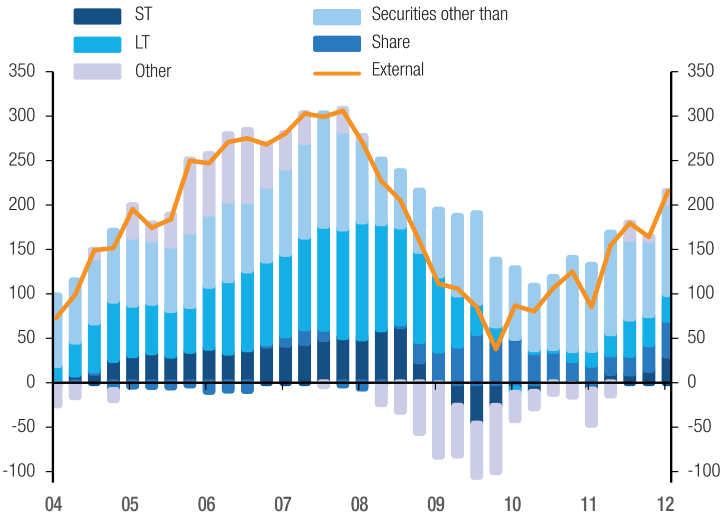


Source : ECB, Bundesbank

(10) The real effective exchange rate (TCER) for the unitary wage cost is an indicator of competitiveness which also takes into account the exchange rate, evolution of the ratio of the cost of labour of a country with its different trade partners. An increase of the TCER corresponds to a decrease of price competitiveness.

(11) Deutsche Bundesbank, *Long-term developments in corporate financing in Germany – evidence based on the financial accounts,* Deutsche Bundesbank, Monthly Report January 2012, Frankfurt.

Graph 10:
External funding of companies in France (2004-2012), moving total over the last four quarters, Billion euros



Source : BCE, Bundesbank, Banque de France

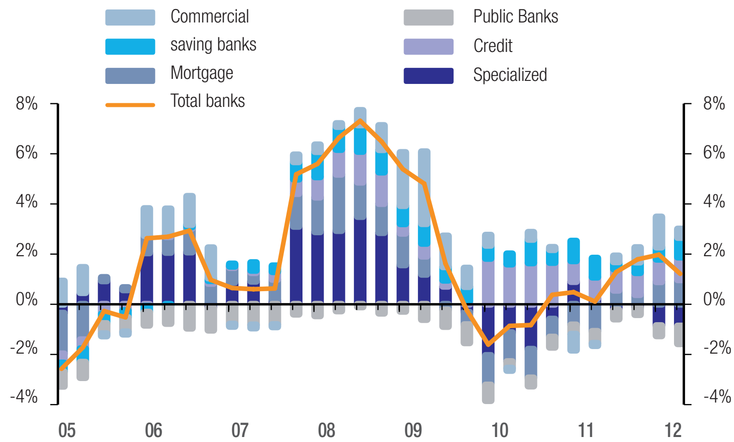
It is difficult to find the causes for this differential between France and Germany. The evolution of the external funding of companies should be analysed with prudence, because a credit contraction may depend both on supply behaviour or demand behaviour. Based on the analysis of a sample of 60,000 French SME observed between 2004 and 2010, Kremp and Sevestre (2011) [12] show that less than 5% of companies with credit suffered from rationing. The econometric study of Rottmann and Wollmershäuser (2010) [13] reached the same finding for Germany: the banks showed less restrictive behaviour on credit matters in 2007-2009 than in 2003-2004. According to these two studies, even if the crisis had led the banks to adopt stricter conditions in terms of granting credit, this was not reflected as much in the rationing of credit for companies, although there was also a contraction observed in 2007-2009 – while this was not essentially – but rather the result of a substantial fall in the demand of companies.

However, apart from these questions of supply and demand, we consider that the stability of the external funding of German companies is also the outcome of important structural factors. The first involves the organisation of the banking system. In Germany, the volume of activity of commercial banks (*Geschäftsbanken*) is effectively limited by the application of a «regional principle», which consists of a geographic division of the retail bank market and of the *Mittelstand* between the savings banks (*Sparkassen*) and credit cooperatives (*Kreditgenossenschaften*). Numerous (1121 credit cooperatives and 431 *Sparkassen* against 280 commercial banks), these establishments account for 22% of the market in terms of assets (after the commercial banks but before the *Landesbanken*) [14] and are deeply entrenched in local terms: the *Sparkassen*, for example, have a radius of action confined to the administrative division of the main owners, municipalities and groups of municipalities.

This regional base, combined with the relatively modest size of these banks, enables the fostering of special relations with client companies. A recent study by Fougère and Sevestre (2012) on the financing and risk of default of these companies in Europe [15] suggests that this proximity between companies and local banks contributed to reducing the funding difficulties of certain companies in 2007-2009. Indeed, the maintenance of long-lasting relations has enabled the reduction in the asymmetry of information of banks vis-à-vis their clients (better assessment of the risk profile and potential of the enterprise), while local banks are also more accommodating during periods of difficulty than their counterparts organised at a national level.

This analysis greatly contributes to understanding the relatively good performance of the external financing of German companies. During the crisis, it was the stability of the funds of the savings banks and credit cooperatives which compensated the contraction of new credit to companies of banks exposed to assets at risk in 2007-2009, and which were then engaged in a deleveraging process (commercial banks and *Landesbanken*). Between Q4 2009 and Q3 2010, a period of contraction of total credit granted to companies, the contribution to the growth of credit of the *Sparkassen* and cooperatives increased, respectively, by +1.3% and +0.6%, against +0.4% and +0.5% on average over the period 2006-2009 (graph 11, page 10). Over this same timeframe, the contribution of the commercial banks and *Landesbanken* was negative by -1.3% and -1% (against +1.8% and +0.9% on average over the period 2006-2009).

Graphe 11:
Contribution to the growth of bank credit to companies in Germany



Source : Bundesbank

(12) KREMP Elizabeth and SEVESTRE Patrick, 2011, «Did the crisis induce credit rationing for French SMEs?», Observatoire des enterprises, Banque de France, Paris.

(13) ROTTMANN Horst and WOLLMERSHÄUSER Timo, 2010, «*A Micro Data Approach to the Identification of Credit Crunches*» CESifo Working Paper Series 3159, CESifo Group Munich.

(14) Public banks organised on the scale of Landers or groups of Landers. Their activity essentially focuses on wholesale banking.

(15) FOUGERE Denis and SEVESTRE Patrick, 2012, «Financement et risque de défaut des enterprises durant la crise — Synthèse d'une conférence organisée par la Banque de France et OSEO les 9 and 12 février 2012», Banque de France, Paris

The role played by the savings banks and credit cooperatives has therefore been essential to the stability of the external financing of German companies during the recent past. It was particularly critical since bank credit represented almost one third of the liabilities of German companies over the period 1991-2010.

However, it should be noted that this has followed a downward trend since the early 1990's: from 32% of liabilities in 1990, bank credit represented no more than 18% of the aggregate balance sheet of companies in 2010. This decline was accompanied by a concomitant increase of commitments with other creditors, whose share has doubled since the early 1990's, from 6% in 1991 to 14% in 2010. This rapid evolution is essentially due to the increasing growth of the use of inter-enterprise and intra-group loans as a form of external funding, especially since the crisis of the 'new economy' in 2000-2002 and the contraction of bank credit which followed in its wake. Indeed, the twenty-first century has witnessed the rapid development of cash-pooling, the centralised management of the treasury of a group of various companies. The principle is simple: each enterprise keeps its own balance sheet and income statement, but the treasury of all the entities is centralised in a pool at group level. This practice has two main advantages: the cash of entities with a surplus can cover the funding gap of other entities via intra-group loans; the group can make loans to the accounts of the different entities, which enables the lowering of funding costs for the smallest companies. These practices, which essentially developed during periods of scarcity of external funding (2003-2004 and 2007-2009), have contributed to the strength the financial situation of German companies which was already solid, also further limiting their exposure to the risk of default.

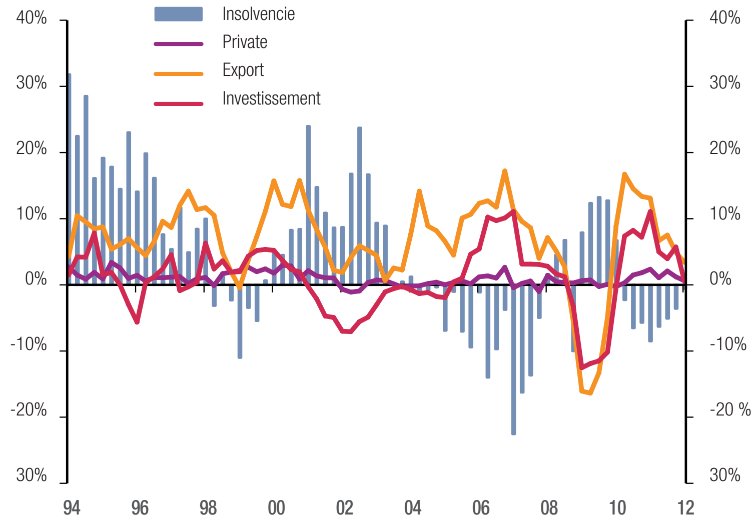
Are German companies therefore invulnerable?

At this point, we have seen that the lower number of insolvencies in Germany might be explained by a motivating insolvency law, the high profitability of companies and stable external financing sources, even during periods of financial turbulence and deleveraging of the banking sector. From the sharing of the value added to the decisions made on matters of economic policy, Germany has placed the companie at the heart of its economic and social development model. As a result of these favourable factors, German companies today are solid. Are they, therefore, totally immune to the current deterioration of European circumstances?

Now that a scenario of a recession in the euro zone for 2012 is looming and activity might still remain subdued in 2013, the question deserves to be posed. Indeed, while Germany continues to be one of the best pupils in Europe with an expected growth of GDP of 0.9% in 2012, its economy is suffering from the crisis. Growth slowed down in the second quarter (+0.3% in Q2 as compared to the preceding quarter against +0.5% in Q1) and expectations of production deteriorated over this summer: in August, the index of confidence of companies IFO retreated for the fifth consecutive month,to 102.3 compared to 105.2 in June, with orders to destinations of the eurozone showing a decline of 4.9% in June relative to the preceding month. The manufacturing sector, strongly export-driven, also shows signs of weakness, with a turnover undergoing contraction of 1.6% in June. Exports did effectively contract by 1.5% in June compared with the preceding month, against +4.6% of growth in that month.

A market slowdown of foreign trade would constitute the principal risk for German companies, which are highly dependent on demand from abroad. In fact, exports currently represent over 50% of German GDP and, historically, the insolvencies appear to be very sensitive to their variations (*graph 12*).

Graphe 12:
Insolvencies, private consumption and exports in Germany (1994-2012), % in GA



Sources : Destatis, Datastream

This finding is confirmed by econometric analysis: according to our estimations for the period 2000-2011, a decline of 10% of exports was associated with an increase in insolvencies of 8%, all other things being equal. This finding is corroborated by the high elasticity between insolvencies and investment (which often represents a substantial part of the GDP of export-driven economies), whose evolution in Germany is closely linked to that of exports. Thus, our estimations indicate that a 10% decrease of investment is associated with an 11% increase in insolvencies, all other things being equal.

In spite of this elasticity which highlights the risk associated to a fall in external demand – notably European – on insolvencies in Germany, Coface has not, at this moment in time, recorded any net deterioration in terms of its payment behaviour in Germany. However, if exports and growth should continue to slowdown over the coming quarters, a return to increased insolvencies cannot be excluded.