

PANORAMA



Corporate insolvencies in France: all good things come to an end

The third quarter of 2018 marks a turning point for companies in France: for the first time in two years, insolvencies increased by 2.3% compared to the same quarter of the year previous. This trend reversal is consistent with the slowdown in growth to 1.6% in 2018.

As this decline in French growth can chiefly be attributed to household consumption, sectors such as personal services, food retail, and automotive have been the most affected by the rebound in insolvencies. At the same time, the slowdown in construction sector activity (27% of the total number of insolvencies) is also reflected in the recent rise in insolvencies. The trend is the same in personal services (which accounts for one insolvency per five).

Unsurprisingly, the reversal in the cycle has until now affected micro-enterprises with revenues of less than EUR 500,000, which have recorded a rise in insolvencies, unlike larger companies. The cost of insolvencies, both in financial and employment terms, has therefore continued to fall. Moreover, this upward trend affects two-thirds of the regions of France.

As a result, the number of insolvencies is expected to start rising again next year: Coface forecasts a 0.8% increase in 2019. This rebound will be attributable, firstly, to the continued slowdown in growth due to ongoing supply constraints and a less

favourable international environment (less vigorous growth among the advanced countries, and greater protectionism). Secondly, the large number of business start-ups in recent years is expected to lead to additional insolvencies, with a company's chances of survival barely exceeding 50% after five years of existence.

Elsewhere, there is a paradox in the evolution of business health over recent years: on the one hand, a constantly improving insolvency and profitability rate, and on the other, disappointing international performances, as shown in the widening trade deficit. A key element of the response is whether companies choose to pass on only partially the competitive gains recorded between 2014 and 2016 in their prices, so as to increase their margin rate. Most key export sectors, such as automotive, pharmaceuticals, aeronautics and the agri-food industry, saw their margin rates rise and their trade balance deteriorate over the period. However, some sectors managed to come out on top and increase their trade surplus over this period, such as mechanical engineering, chemicals, alcoholic beverages and precision instruments. In addition, this restoration of margins in key export sectors could prove an advantage for regaining market share in a less favourable environment in the years to come. In addition, this recovery in margins in key export sectors could prove to be an asset in cushioning the impact of the slowdown in global demand in the coming years.

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1 THIRD QUARTER WAS A TURNING POINT; REBOUND IN INSOLVENCIES

At the end of September 2018, 52,410 companies went bankrupt year-on-year, 4.5% less than a year earlier. Although this number is well below its 2009 – 2016 levels (**Chart 1**), it is again increasing from the low point reached last May (52,113 insolvencies).

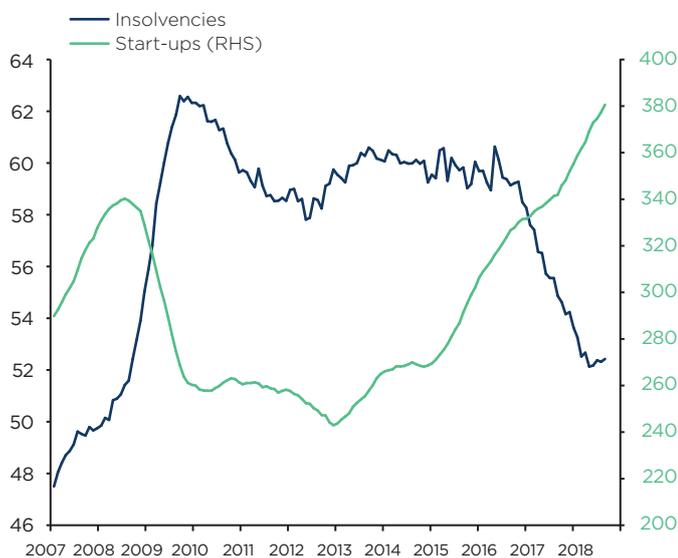
In the first five months of the year – with the exception of April – the monthly number of insolvencies was consistently lower than for the same months in 2017, which were already very good compared to previous years (**Chart 2**). The trend then reversed: June, July, and September saw more bankruptcies year-on-year (5,076 insolvencies recorded).

As a result, the insolvencies recorded for the third quarter of 2018 increased by 2.3% compared to the same quarter last year, after eight consecutive quarters of decline (**Chart 3**).

In addition, the average age of an insolvent company remained stable over the period, standing at 81.1 months at the end of September, exactly the same level as in 2017. The life expectancy of companies has therefore stabilised after having steadily increased since 2011 (68.8 months).

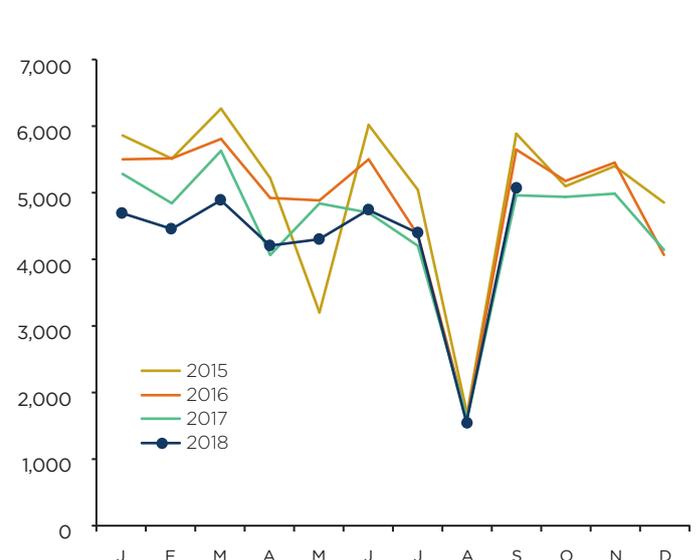
At the same time, start-ups remained very buoyant (+11.4% year-on-year in September 2018), reaching 380,788 excluding the self-employed (**Chart 1**).

Chart 1:
Insolvencies and business start-ups (in thousands, annually)



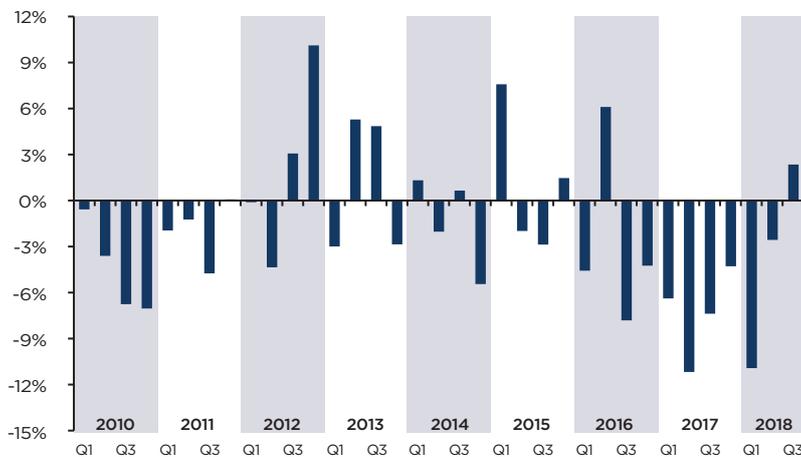
Sources: Ellipsphère, INSEE, Coface

Chart 2:
Monthly business insolvencies



Sources: Ellipsphère, Coface

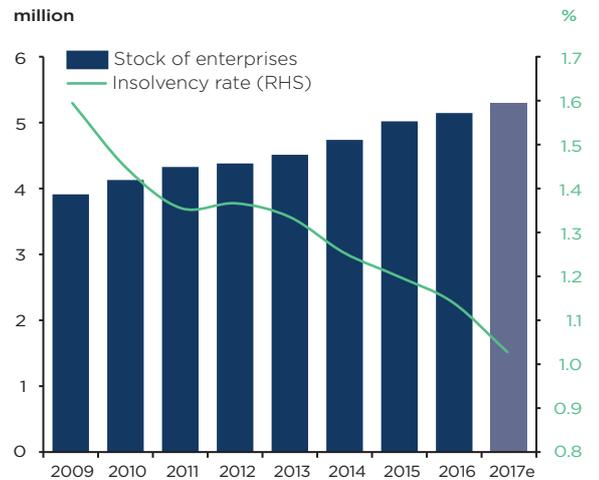
Chart 3:
Quarterly business insolvencies
(yearly growth)



Sources: Ellispère, Coface

Business start-ups even accelerated in 2018, despite the slowdown in activity, after rising 6.2% in 2017. However, this dynamic will be negatively reflected in the evolution of insolvencies over the next few years, a company's chances of survival being barely higher than 50% after five years¹.

Chart 4:
Insolvency rate and stock of enterprises



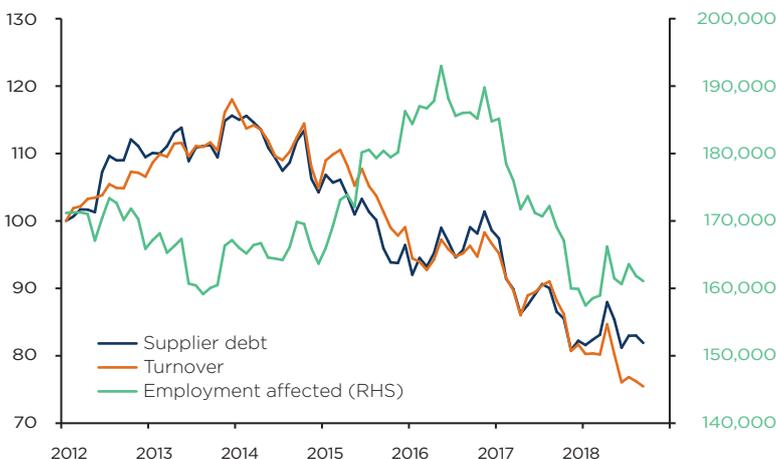
Sources: Ellispère, Insee, Coface

In this context, the total number of companies has continued to increase, reaching 5.3 million units as of the 1st January 2017, according to Coface estimates². The insolvency rate therefore logically continued to decline to stand at around 1% in 2017, after 1.14% the previous year (Chart 4).

2 MICRO-ENTERPRISES, THE FIRST TO BE AFFECTED BY THE REVERSAL IN THE CYCLE

Chart 5:
Cost of insolvencies

100 = January 2012



Sources: Ellispère, Coface

The financial cost of insolvencies for the economy, measured by the sum of outstanding trade payables, decreased slightly to EUR 3.2 billion year-on-year (-5.4% compared to September 2017). At the same time, the cost in terms of jobs has also fallen: 160,893 jobs were affected by insolvencies year-on-year to the end of September, down 4.8% (Chart 5).

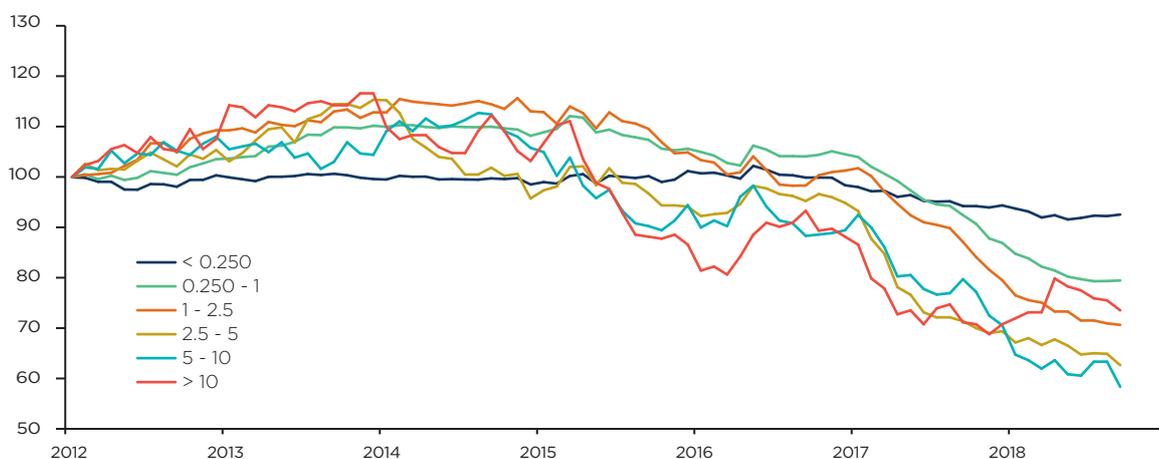
This decrease in the cost of insolvencies, which is also reflected in the average revenue of bankrupt companies (EUR 304,000, or -11% year-on-year), is explained by the improved health of the largest companies (Chart 6). While the number of insolvencies for enterprises with revenue below EUR 250,000 (over 80% of insolvencies) decreased by 1.9% year-on-year in September 2018, the others recorded a far more severe decrease (-15.1%).

1 K. Ait-Yahia, B. De Moura Fernandes, P. Weil, Coface Panorama: Companies in France: fewer business insolvencies, but still just as many "zombies", Coface, March 2018.
2 The estimate of the stock of enterprises at 1st January 2017 is obtained by applying the ratio of the total number of enterprises to that in the non-agricultural business sector in 2015 and 2016 (1.18) to the stock of non-agricultural business sector enterprises available for 2017 (4,495,383 enterprises according to INSEE).



Chart 6:
Insolvencies by turnover brackets (in million euros)

100 = January 2012



Sources: Ellisphère, Coface

Although the average revenues of insolvent enterprises declined for the economy as a whole, two sectors saw the cost of their insolvencies rise sharply: agri-food (+29.7%) and distribution (+8.7%). In 2018, two of the five largest insolvencies were in the meat sector: DOUX, with sales revenue of EUR 316.1 million and the cooperative UKL-Arrée (EUR 216.5 million). In the retail sector, the toy segment was particularly affected, notably by the strength of e-commerce, as illustrated by the insolvencies of TOYS'R'US and LUDENDO (sales revenue of EUR 326.8 and EUR 151.4 million respectively).

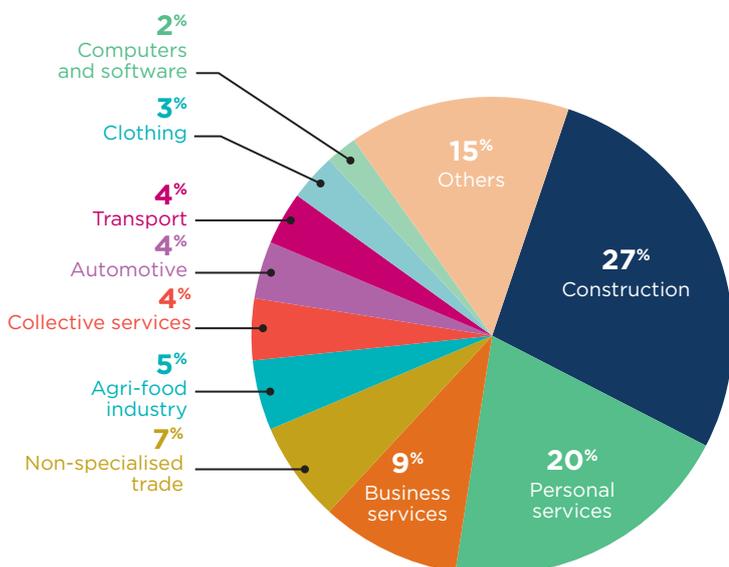
Furthermore, the reversal in the trend of recent months can be attributed solely to micro-enterprises, which are the first to be affected in downturns. If we compare the number of insolvencies from the third quarter of 2018 to those for the same quarter in 2017, only companies with revenue of less than EUR 250,000 or between EUR 250,000 and EUR 500,000 recorded increases in insolvencies (+3, 8% and +1.8% respectively). All other company categories continued to experience a reduction during the third quarter.

This deterioration relates to the two sectors that have traditionally seen the highest number of insolvencies: construction and personal services, which alone account for almost half of total insolvencies (**Charts 7 and 8**).

Naturally, insolvencies were affected by the slowdown in the construction sector, as reflected in the decrease in building permits, which peaked in October 2017 (**Chart 9**). All major segments recorded higher insolvencies in the third quarter of 2018 compared to the same quarter last year: general masonry and structural work (+3%), painting and glazing (+11%), electrical installation work (+14%) and single-family home construction (+14%).

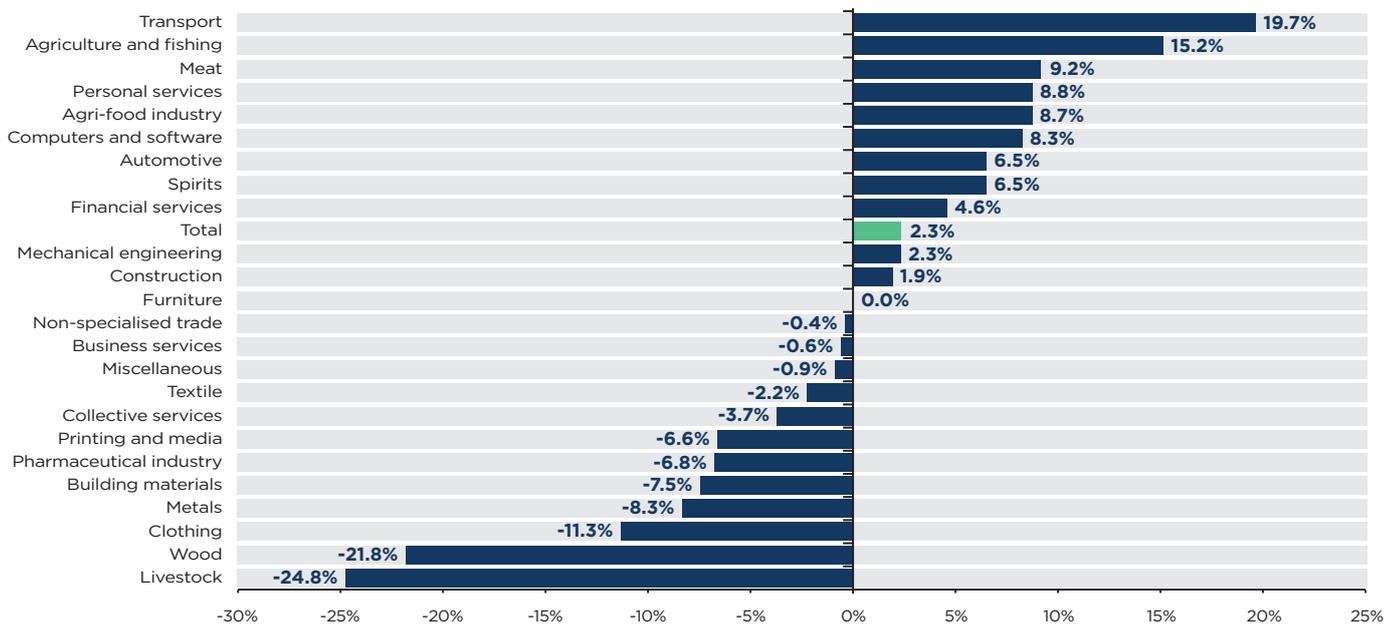
At the same time, the increase in insolvencies in personal services is part of a slowdown in household consumption in 2018. Thus, the main areas affected were fast food (+25%) and traditional restaurants (+2%), drinking establishments (+14%), and hairdressing (+4%).

Chart 7:
Breakdown of insolvencies by sector
in the third quarter of 2018 (over 12 months)



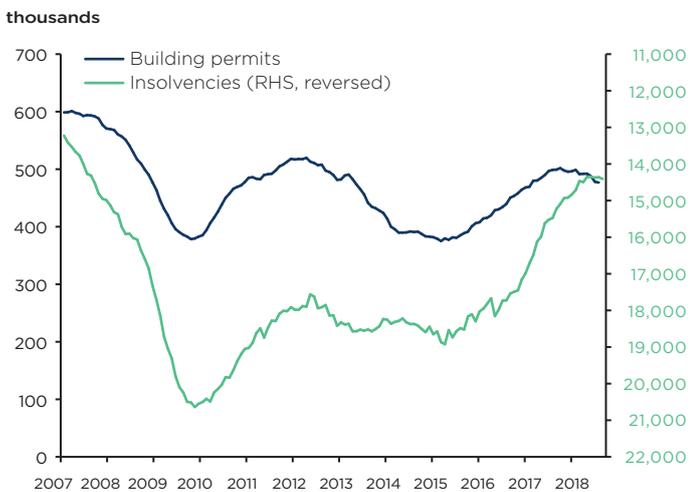
Sources: Ellisphère, Coface

Chart 8:
Insolvencies by sector in the third quarter of 2018 (yearly growth)



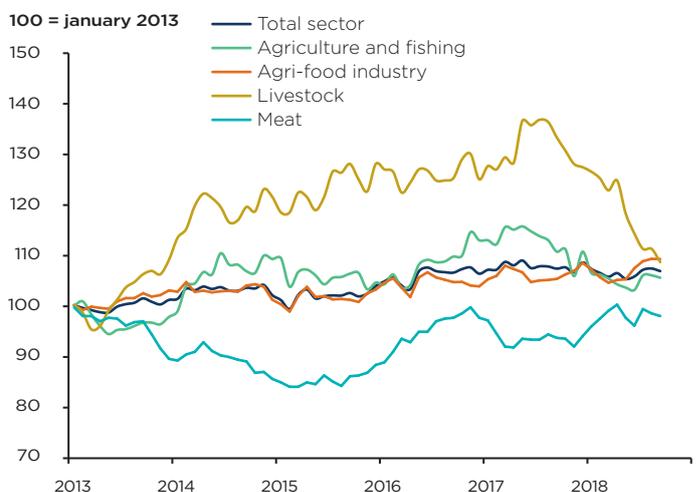
Sources: Ellisphère, Coface

Chart 9:
Building permits and insolvencies in the construction sector



Sources: Ellisphère, Insee, Coface

Chart 10:
Insolvencies in the agri-food sector



Sources: Ellisphère, Coface

Apart from these two main sectors, agri-food as a whole showed a rise in insolvencies in the third quarter of 2018 (+5.7%), due to several areas (**Chart 10**): agriculture (led by cereals), meat (butchery) and the agri-food industry (bakery and pastry, food retail). Although these sectors have been affected by sluggish consumption, the evolution in insolvencies can also be chiefly attributed to the structural change in distribution methods mainly brought about by e-commerce.

In addition, the situation has also deteriorated for car dealers (+19%), despite strong vehicle registrations in 2018. Lastly, it is the transport sector that has seen its number of insolvencies increase the fastest. While taxis have continued to experience great difficulties (+43%), against the background of competition from private hire vehicles³, insolvencies also grew in road freight transport (+15%).

3 G. Rippe-Lascout, V. Ternisien, *Panorama Coface: Uberisation of French economy: a positive impact on employment but will it last?*, Coface, December 2016

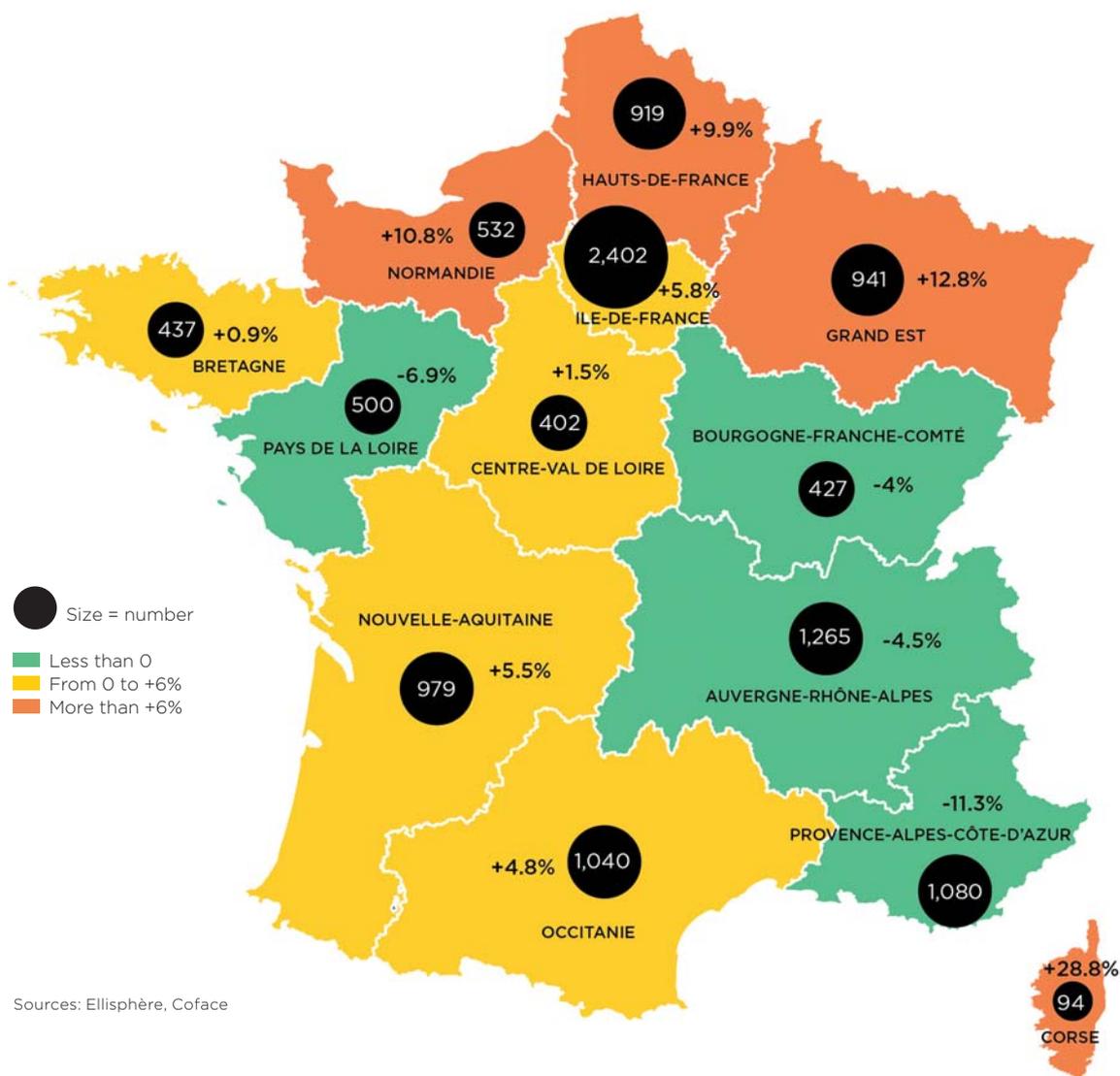
3 THIRD-QUARTER INSOLVENCIES INCREASE AGAIN IN MOST REGIONS

Most regions have been affected by the recent reversal in trend: nine out of thirteen regions saw an increase in insolvencies compared to the third quarter of 2017 (Chart 11). Only Pays de la Loire, Bourgogne-Franche-Comté, Provence-Alpes-Côte-d'Azur (PACA) and Auvergne-Rhône-Alpes still benefit from a decline in business insolvencies. These last two regions, ranking respectively 2nd and 3rd in numbers of insolvencies after Île-de-France, therefore limited the resurgence in insolvencies nation-wide during the third quarter. In the PACA region, this good performance is mainly due to the vigour of the construction sector (-24%). In the Auvergne-Rhône-Alpes region, the

automotive and personal services sectors posted robust health and lower insolvencies.

Conversely, the trend has been reversed in Île-de-France, where - in keeping with its economic weight⁴ - more than 20% of insolvencies were recorded. The increase in Île-de-France insolvencies can be ascribed to the poor performance of four important sectors, similar to those that are in difficulty nationally: the agri-food industry (+14%, driven by bakery and pastry, and food retail), automotive (+23%, car dealers), transportation (+19%, taxis) and personal services (+5%, fast food, driving schools).

Chart 11:
Insolvencies in France (in the third quarter of 2018)



Sources: Ellipsère, Coface

4 According to INSEE, Île-de-France accounted for 30% of GDP and 24% of businesses across the country in 2015.

Insert 1:

Heading for an increase in business insolvencies in 2019

According to Coface's forecasting model, business insolvencies will fall by 3.4% over the whole of 2018, in line with our forecasts of last March⁵, before rising by 0.8% in 2019 (**Chart 12**) to reach 52,838 insolvencies:

$$Insolv_q = -404.2GDP_{q-2} + 0.36Insolv_{q-1} - 171.5ConstructionConf_{q-1+\epsilon}$$

(0.03) (0.02) (0.01)

This rebound in the number of insolvencies is attributable to all of the model's variables⁶. Activity, measured here by GDP growth, should continue to decelerate. According to the Coface forecast, GDP growth will decline from 1.6% to 1.5% in 2019, due firstly, to a deteriorating international environment (slowdown of main partners, increased protectionism), and secondly to continued supply constraints in the French economy, both in terms of production capacity and manpower. In addition, with the construction sector continuing to slow down, the confidence index for construction should continue to fall in 2019.

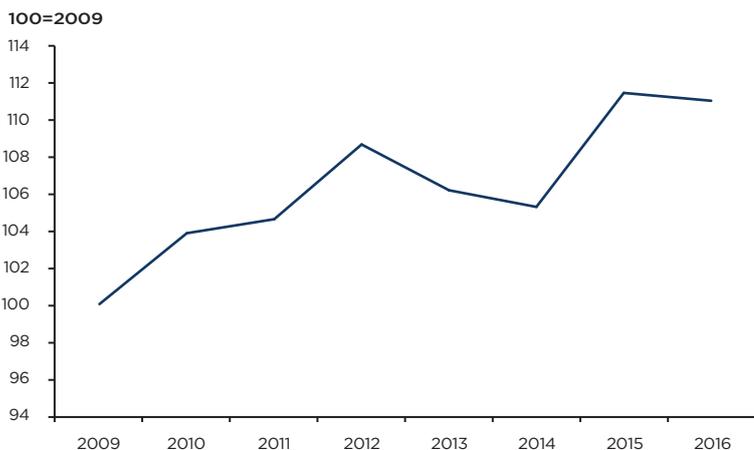
Chart 12:
Business insolvencies over 12 months



Sources: Ellisphère, Coface

4 MARGINS RECOVER AT THE EXPENSE OF EXPORT PERFORMANCE

Chart 13:
Business cost competitiveness



Sources: INSEE, Coface

Before the trend reversal in the third quarter of 2018, the decline in insolvencies illustrated an improvement in the health of companies in France since 2014. Although the number of insolvencies decreased by only 1.3% between 2014 and 2016, the rate of insolvencies fell, with the stock of companies increasing by 8.6% over the period (**Charts 1 and 4**). The profitability of non-financial corporations increased, both on the basis of net income (which rose from 4% to 5.2% of turnover excluding taxes) and on the basis of gross operating income (from 6.3% to 6.9%). This improvement in the health of companies over this period was accompanied by a 5.5% increase in cost competitiveness⁷ (**Chart 13**), due to the entry into force of the tax credit for competitiveness and employment (CICE) and the reduction in employer contributions under the Responsibility and Solidarity Pact.

5 K. Aït-Yahia, B. De Moura Fernandes, P. Weil, *Coface Panorama: Companies in France, fewer business insolvencies, but just as many "zombies"*, Coface, March 2018

6 The variable "change in the construction sector confidence index in the previous quarter" is significant within a 99% confidence interval. Likewise, the variables "GDP growth two quarters before" and "change in business insolvencies in the previous quarter" are respectively significant in confidence intervals of 97% and 98% respectively. Therefore the forecast model is significant in the standard 95% confidence interval.

7 The cost-competitiveness indicator compares France's unit wage costs with those of its 23 main OECD partners.

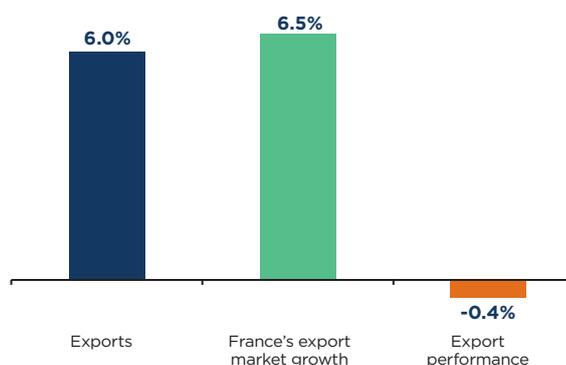


Paradoxically, this generally better health of companies, having led to gains in cost competitiveness, did not translate into better export performance: exports grew by 6% between 2014 and 2016; a 0.4 percentage point less than the demand addressed to France by its trading partners (Chart 14). At the same time, the trade deficit excluding energy increased from EUR 21.2 billion to EUR 34.8 billion. More than two thirds of the non-energy sectors⁹ recorded a deterioration in their trade balance⁹, the most notable fall being in transport equipment, where the surplus fell from EUR 14.8 billion to EUR 9 billion (-39%). Consequently, despite a significant improvement in its cost-competitiveness, although France was able to halt the decline in its export performance

recorded in the 2000s (Chart 15), it was unable to trigger a rebound. As a result, France's global market share did not increase over the period, stagnating at 3.5% of world exports, compared to 5% at the beginning of the 2000s. The number of exporting companies – which grew by only 1% between 2014 and 2016 and remains below the 2010 level – confirms this observation¹⁰.

This observation is all the more notable as it differs from the other main economies of the eurozone. While Germany was the exception in the 2000s, with Spain and, above all, Italy seeing their export performance decline¹¹ like France, the trend was then reversed. Since 2014, Italy and, above all, Spain have also seen their export performance improve (Chart 16). However, according to the OECD, cost competitiveness improved much less during this period in Italy (+0.9%) and Spain (+2.2%), and even decreased in Germany (-0.3%).

Chart 14:
Change in France's export performance
between 2014 and 2016 (in %)



Sources: INSEE, OECD, Coface

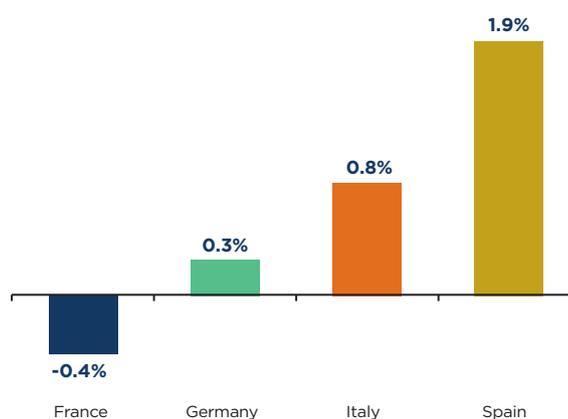
This relative disconnect between France's cost-competitiveness gains and export performance over this period can be explained by the fact that companies only partially passed on these cost-competitiveness gains in their export prices (Chart 17). Although companies did not fully reflect their loss of price competitiveness before the crisis in order to limit the extent of their loss of market share, they adopted the opposite behaviour in the recent period. The price competitiveness¹² of companies therefore only increased 1.5% between 2014 and 2016 (Chart 17).

Chart 15:
Export performance and market shares of France's
exports in global trade



Sources: OECD, Coface

Chart 16:
Changes in export performance of the major euro area
economies between 2014 and 2016 (in %)



Sources: OECD, Coface

8 France's trade deficit decreased from EUR 76.1 billion to EUR 66.5 billion between 2014 and 2016 due to the reduction in the energy bill, in line with the fall in oil prices over the period.

9 Of the 66 non-energy sectors of the aggregated classification A129, 45 experienced a deterioration in their trade balance

10 According to Customs data, 89,381 companies in the non-agricultural and non-financial commercial sector exported in 2016, compared to 91,551 in 2010.

11 Between 2000 and 2008, Spain's and Italy's export performance decreased by 13% and 26% respectively. In contrast, Germany recorded export performance gains of 5%.

12 Export price competitiveness equals the ratio of the foreign benchmark price to the French export price. The foreign benchmark price is a weighted average of the export prices of 23 of France's OECD trading partners.

In other words, companies have preferred to restore their margin rate – which had become eroded in the 2000s especially during the crisis of 2008 (**Chart 18**) – rather than gain export market share. This behaviour was particularly pronounced in the manufacturing industry, where the margin rate increased by almost 3 points between 2014 and 2016, twice as much as all non-financial companies.

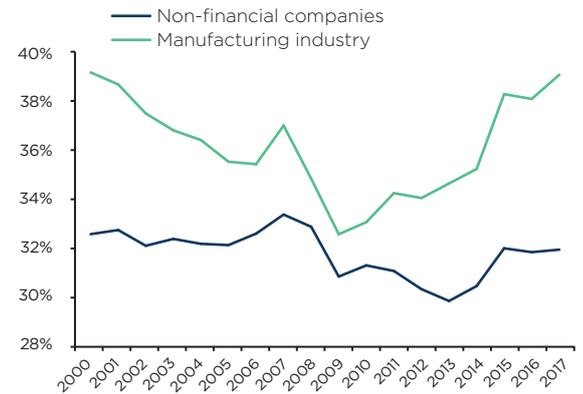
Predictably, the trade balance of 60% of the 25 industries – excluding energy and agriculture – deteriorated during this period (**Chart 19**). For the vast majority of these sectors, this deterioration was accompanied by an increase in the margin rate, confirming the trend in macroeconomic terms. The choice by companies in most sectors to increase their margin rate improved their financial position to the detriment of their international performance.

Chart 17:
Cost competitiveness and price competitiveness



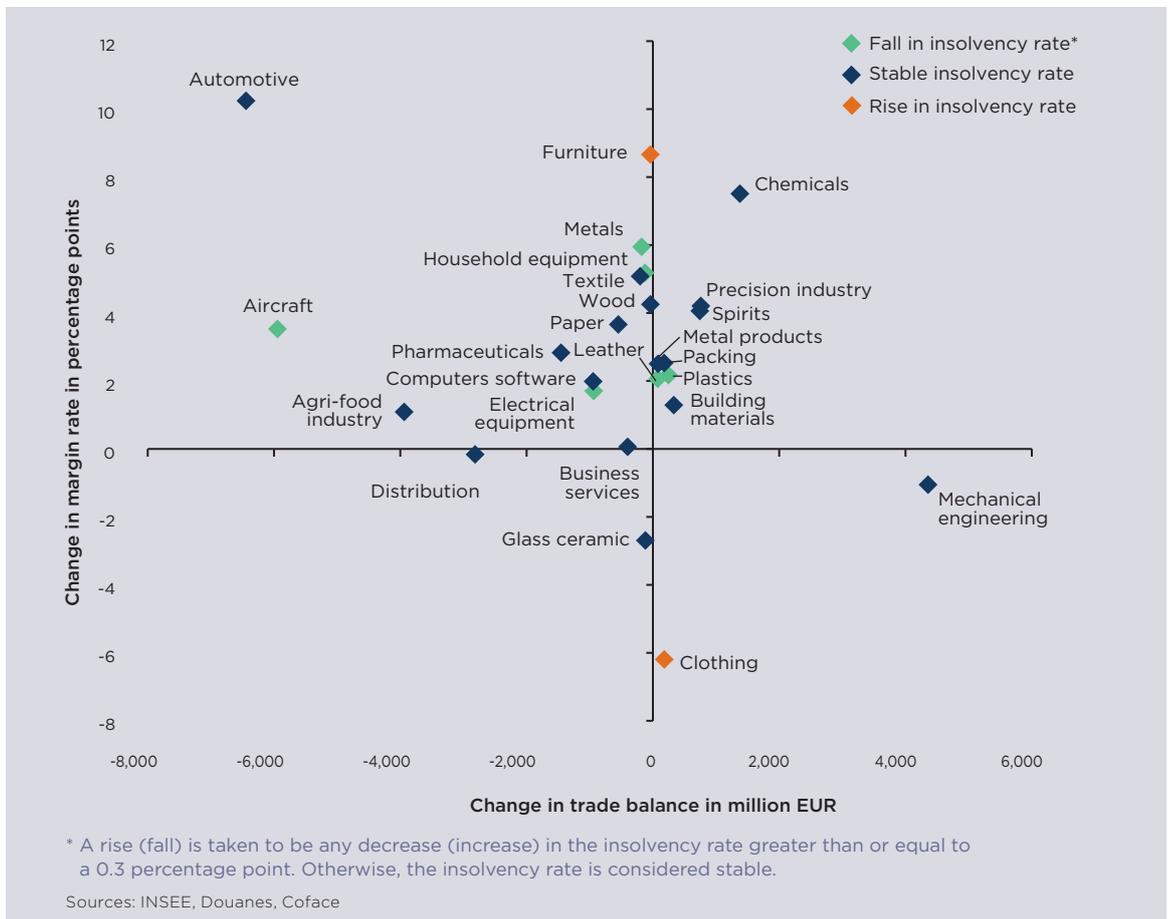
Sources: INSEE, Coface

Chart 18:
Corporate margin rate



Sources: INSEE, Coface

Chart 19:
Change in trade balance and margin rate by sector between 2014 and 2016





Higher margins and trade balance: chemicals, alcohols and precision instruments took full advantage of the boom period

In this relatively negative panorama of international performance, some sectors nevertheless increased their margins while improving their trade balance. The most notable of these is the chemicals sector, whose trade surplus has increased thanks to falling imports, particularly for the manufacture of pesticides, plastics and basic organic chemicals – all while substantially improving its margin rate. This performance is explained, on the one hand, by measures supporting competitiveness and, on the other hand, by the fall in input costs, linked to the price of oil, which fell from an average of USD 100 per barrel in 2014 to USD 44 in 2016.

Exports of precision instruments, including weapons and navigational aids equipment, were also dynamic over the period, allowing the sector to increase its trade surplus. In addition, the alcoholic beverage industry – one of the main sources of trade surplus for France – recorded a sharp increase in its exports of champagne and spirits.

The margin rate and trade balances of the packaging, plastics, building materials, and leather (leather goods) segments also improved.

Few sectors have reduced their margin rates in order to gain international market share

The mechanical engineering industry saw its trade surplus increase significantly between 2014 and 2016, thanks to the strength of exports in the business-to-business segment of industrial equipment and, to a lesser extent, agricultural machinery. This excellent performance is due in particular to the reduction in its margin rate over the period.

On the other hand, the trade deficit in clothing fell slightly between 2014 and 2016, thanks to an increase in exports for business-to-business trade. However, the sector's financial situation deteriorated significantly over the period: the margin rate fell and the default rate rose sharply.

The aeronautics, automotive, pharmaceuticals and agri-food sectors saw their trade balance deteriorate, compensated by restored margins¹³

The majority of key export sectors increased their margins, while recording a deterioration in the trade balance between 2014 and 2016. The automotive industry is a perfect illustration of this dynamic: the trade deficit has widened sharply due to a sharp increase in imports, equipment and, above all, vehicles, both for production and distribution. This was achieved while substantially increasing its margin rate (+10 points), thanks to the fall in oil prices.

The other key export sectors, aeronautics and pharmaceuticals, also recorded a sharp decline in their trade surplus, while increasing their margin rate. In both cases, exports grew slightly between 2014 and 2016, but at a much slower pace than imports. All segments of the pharmaceutical and cosmetics sector have increased the use of foreign products. While the default rate remained stable in the pharmaceutical industry despite the recovery in margins, it fell in the aerospace sector (-1 point). The latter, which sells its aircraft in US dollars, has benefited particularly from the depreciation of the euro¹⁴.

In addition, the trade deficit of the agri-food industry widened, due to the increase in imports (+10%), mainly for the wholesale of fruit and vegetables.

Although having a lower weight in exports, the ICT and electrical and domestic capital goods sectors are in the same situation. Manufacturers and distributors of household appliances have increased their imports. The same is true for the electrical equipment sector, where imports for the manufacture of communications equipment have risen sharply. However, thanks to the significant improvement in their margins, both electrical and household equipment goods saw their default rates fall (-0.8 and -0.4 percentage points respectively).

¹³ The situation is almost identical for the distribution sector (non-specialised trade and e-commerce), where the margin rate has remained stable and the challenge cited has increased. This is due to the development of e-commerce, with imports rising from EUR 4.3 billion to EUR 6.2 billion, while exports rose from EUR 1.9 billion to EUR 2.5 billion at the same time.

¹⁴ The euro exchange rate rose from an average of USD 1.33 in 2014 to USD 1.11 in 2016. Therefore, the same Airbus A320 sold for USD 100 million increased Airbus' revenue by EUR 90 million in 2016, compared to EUR 75 million in 2014.

A safety net in 2019?

Although the recovery of margins between 2014 and 2016 had a negative short-term impact on export performance, in the medium-term this strategy could prove to be an asset for French companies.

After having increased steadily between the low point of 2013 and 2016, the margin rate of non-financial companies has since stabilised. It remained virtually unchanged throughout 2017 and in the first quarter of 2018, at 32% value added.

According to Coface's forecast, the margin rate should remain stable in 2019. On the one hand, the price of a barrel of oil, a key factor for companies' production costs, is expected to remain stable in 2019, at around USD 75 on average¹⁵. On the other hand, the measures contained in the 2019 finance bill are not expected to have a significant impact on the health of companies. The changeover of the CICE to a permanent reduction in employers' contributions will have different effects, depending on the intensity of the sectors with low-skilled labour. Nevertheless, due to the significant increase in companies' taxable profits, this

measure will have a negative net effect of around EUR 4 billion in 2019 (or 0.3 points of the value added of non-financial companies), according to Coface estimates. In addition, interest rates, which have an effect on the cost of capital, are expected to remain low and gradually rise only at the end of the year. However, this overall negative effect should be offset by the continued increase in productivity, which contributed +0.4 percentage points to the growth in the margin rate in 2017.

As a result, the margin rate should remain stable at a comfortable level, and French companies could use this margin to mitigate the impact of the slowdown in world trade, or even achieve export performance gains.

This could particularly be the case in the key export sectors: aerospace, automotive and pharmaceuticals have returned to particularly high margins. The chemical industry has also fully benefited from lower oil prices to increase its margin rate to almost 40%. Such leeway should allow these key sectors to remain competitive despite the rise in oil prices recorded in 2018. They could also potentially win back market share, if that is their strategy.

15. A barrel of oil averaged USD 73.5 between the 1st January and the 31st October 2018.

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