Insolvencies in Europe

2005/06

A survey by the
Creditreform Economic
Research Unit

Creditreform

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1 Introduction

The world economy continues to enjoy a phase of active growth, although the pace is slowing down. The increase in production weakened from five percent (2004) to about four percent in 2005, while the growth in world trade retreated from eight to seven percent.

The economy of the eurozone grew by approximately two percent last year. In contrast to the United States, where forecasts suggest a slight easing of economic growth (from about 3.6 to 3.4 percent), the eurozone is picking up. In six of the twelve countries in the eurozone, the growth rate accelerated, evidence of the breadth of the recovery.

Europe back on growth course

The surge in the international economy has so far affected domestic demand only to a limited extent. Gross capital investment moved upward in the second half of 2005, driven by rising corporate investments in plant and equipment. European industry is definitely recovering, but the advance is still only hesitant. It must also be kept in mind that the economies of the key eurozone states are fuelled by very different forces. While Germany's economy has always been largely export-driven, the growth in France and Spain has been supported by strong consumer demand and construction activity.

In this survey, Creditreform presents – for the 16th time – an analysis of corporate stability and the insolvency picture in Europe at the interface between the state of the economy, business access to financing and the various legislative modalities in the countries concerned.

2 Insolvencies in Western Europe in 2005

2.1 Corporate insolvencies

The number of corporate insolvencies in the EU-17 countries decreased by 2.0 percentage points to 147,239. The year before there were still slightly over 150,000 business bankruptcies (150,312).

So for the first time in four years, corporate insolvencies in Europe posted a negative trend: the total is only slightly higher than in 2002, when just 146,438 bankruptcies were recorded.

Table 1: Corporate insolvencies in Western Europe (2002 – 2005)

■	2005	2004	2003	2002	Change 2004/05 in percent
Austria	7,299	6,328	5,643	5,281	+ 15.3
Belgium	7,790	7,836	7,593	7,222	- 0.6
Denmark	2,423	2,620	2,506	2,469	- 7.5
Finland	2,134	2,385	2,769	2,885	- 10.5
France	42,874	40,776	38,296	37,987	+ 5.1
Germany	37,900	39,270	39,470	37,620	- 3.5
Great Britain	10,344	12,813	14,815	17,094	- 19.3
Greece	640	577	480	489	+ 10.9
Ireland	252	321	346	379	- 21.5
Italy	11,000	10,700	10,463	10,683	+ 2.8
Luxembourg	668	665	655	695	+ 0.5
Netherlands	6,274	6,648	6,386	6,489	- 5.6
Norway	2,293	2,683	3,084	2,603	- 14.5
Portugal	3,300	3,123	2,980	2,092	+ 5.7
Spain	549	561	646	629	- 2.1
Sweden	6,748	7,649	8,237	7,819	- 11.8
Switzerland	4,751	4,955	4,539	4,002	- 4.1
Total	**147,239**	**150,312**	**148,908**	**146,438**	**- 2.0**

Six of the 17 Western European countries covered in this survey show an increase in corporate insolvencies. The list is headed by Austria, where the total was up by 15.3 percent to 7,299 in all. In addition, more than half the petitions for bankruptcy (52.4 percent) had to be dismissed for lack of sufficient assets. In such cases creditors can expect their claims to be a total loss. The all-time record number of corporate failures in Austria affected around 25,000 employees; the volume of damage remained at more or less the prior-year level (2.3 billion euros), a fact attributable to the absence of any really big collapses in 2005. In Austria, as elsewhere, insolvencies are for the most part a problem of small and medium-sized enterprises (SMEs). In the autumn of 2005 Creditreform surveyed

over 1,700 Austrian companies regarding their business health and prospects for the near future. The results match closely with the estimated number of corporate failures: 46.1 percent of the respondents assessed their current business situation as very good or good, a decline of 9.7 percentage points in the course of a year. A little under a fifth of the companies (19.8 percent; previous year: 14.9 percent) reported declines in sales. Austria's SMEs also face a worsening equity capital situation. At present, only 27.1 percent of all companies – as against 31.2 percent in 2004 – have a stable equity position of more than 30 percent of their balance sheet total. And 31.2 percent of the companies surveyed have equity ratios of less than 10 percent, and must thus be considered under-capitalized (previous year: 27.4 percent).

Upheavals and rising insolvency figures

Greece also reports a double-digit increase in insolvencies. The bankruptcy rolls there grew by 10.9 percent to a total of 640. For several years now the Greek economy has been undergoing a real upheaval, characterized by strong growth and modernization, and aimed at getting closer to the average European level of performance. Greece has been moving farther and farther away from its strongly agricultural origins to become a society oriented more to commerce and services. This process is accompanied by increasing insolvencies.

Growing corporate insolvency figures continue to be posted by Portugal (up 5.7 percent to a total of 3,300), France (up 5.1 percent to 42,874), Italy (plus 2.8 percent to 11,000) and Luxembourg (plus 0.5 percent to 668).

The greatest decline in corporate insolvencies is reported by Ireland. The number of business failures there decreased by 21.5 percent, to a total of 252. By way of comparison: the city of Mülheim an der Ruhr in Germany counted 240 corporate bankruptcies in 2005. The ifo institute regards Ireland’s small and open economy as one of the greatest beneficiaries of globalization anywhere in the world. Economic development has been distinguished in recent years by

high growth rates and a strong fall in unemployment – the unemployment rate expected for 2005 as a whole was 4.2 percent.

Stabilization in Great Britain

In second and third place among the countries with the greatest declines in insolvencies are Great Britain and Norway. Great Britain has already been reporting a steady fall in corporate bankruptcies for four years now, and the 2005 total was just 10,344, a year-on-year drop of 19.3 percent. Norway's insolvency volume started falling in 2004. After over 3,000 cases in 2003, the figure fell to 2,683 in 2004 and then to 2,293 last year – a further decrease of 14.5 percent.

For the second year in a row, France accounted for the largest share of the European insolvency volume. In all, 42,874 corporate insolvencies were counted there, representing an increase of 5.1 percent from the year before. As recently as 2003, Germany still headed the insolvency charts, with just over 40,000 business bankruptcies, but since then it has seen a slight downward trend to the current level of 37,900 (a fall of 3.5 percent from 2004).

Table 2: Insolvency ratios in the individual Western European countries

■	Insolvencies per 10,000 companies
Spain	2
Greece	8
Ireland	26
Italy	26
Portugal	26
Great Britain	66
Norway	72
Finland	88
Belgium	112
Sweden	127
Netherlands	129
Germany	130
Denmark	132
Switzerland	155
France	167
Luxembourg	252
Austria	288
Average overall	**77**

Chances of corporate survival

The relative insolvency rates for the individual countries are obtained by comparing the number of insolvencies with the total number of firms. Spain, with only two insolvencies per 10,000 enterprises, traditionally fares best in the Western European insolvency rankings, but – as explained in previous surveys – this is due less to a flourishing economy than to idiosyncrasies of law. Despite a comprehensive reform of Spanish insolvency legislation in September 2004, regulated exit from the market by small limited companies in particular has not yet established itself. Before the legal reform, the expensive and complicated liquidation procedure was often not considered worthwhile, so many "corporate ruins" remained in the registers. It was hoped that the introduction of the new insolvency law would provide more effective liquidation mechanisms, but whether these will actually take hold remains to be seen.

At the lower end of the scale is Austria – it reported not only the greatest percentage growth in corporate insolvencies, but also the highest proportion of business failures: 288 of every 10,000 firms in Austria had to file for bankruptcy in 2005. This compares badly with last year's EU-17 average of 77 firms in every 10,000, which was down from an average of 81 insolvencies per 10,000 companies the year before. Germany ranks in the lower middle range of the list, with 130 insolvencies per 10,000 companies.

Still no European insolvency law

The European Union had intentionally refrained from introducing a uniform insolvency law. The "European Union Council Regulation on Insolvency Proceedings" governs cross-border insolvency proceedings within the EU; however it does not create uniform material insolvency law, but only makes stipulations to govern conflicts, in the interest of uniformity within the EU. The European Court of Justice has now for the first time rendered a verdict on the interpretation of cross-border insolvency proceedings, and has thereby strengthened the position of the affected creditors. It found that jurisdiction for the decision on opening bankruptcy proceedings resided exclusively with the court with which the application was filed, even if the debtor had already moved his primary domicile to a different member country before the opening of proceedings. Only in this way could the affected creditors be guaranteed greater legal certainty. The Regulation was specifically intended to prevent assets or legal disputes from being moved from one member state to another to the benefit of the debtor, because otherwise creditors would have to follow the debtor to wherever he chose to reside.

2.2 Private indebtedness

Not all the insolvency legislations of the countries being considered offer private individuals the opportunity to shed their debts permanently and make a fresh start. Germany introduced its consumer insolvency procedure, with exemption from residual debts, in 1999. Since then the procedure has been under constant fire from critics, who complain that it is

too expensive, too complicated and unfriendly to creditors. Following a reform in 2001 that resulted in a tremendous – and still ongoing – increase in applications, there are now plans for sweeping changes.

These changes will make a distinction between those debtors able to offer their creditors pro-rata restitution and those who cannot. Debtors who have attachable income or assets that can be used to satisfy the claims of creditors will be eligible to go through insolvency proceedings and obtain exemption from residual debts. The length of the good conduct period will probably depend on the level of the restitution rate, in order to create an incentive for debtors. For a creditor restitution rate of 20 percent the good conduct period is to be reduced to four years, and for 40 percent to just two years.

Reminding debtors of their responsibility

In those cases where debtors cannot even cover the court costs, there will be no insolvency proceedings. After the expected amendment to the law, such debtors are to go through a so-called debt clearance procedure. That is intended to create a certain “nuisance potential” for those affected, in order to motivate them to aim for a proceeding for exemption from residual debts. Distraint will continue to be an unrestricted option in the debt clearance procedure, which will have a duration of eight years, compared to six years in the past. Another stipulation is that the debtor will be relieved only of those debts that he himself has declared.

In 2005 the number of private insolvency applications in Germany got very close to the hundred-thousand mark. The total of 98,400 applications represents an increase of 24.6 percent (2004: 78,990). Assuming – as the Federal Ministry of Justice does – that at least 3.1 million households in Germany are over-indebted, no end to this upward trend is in sight.

Table 3: Private insolvencies in Europe

■	2005	2004	Change 2004/05 in percent
Austria	6,300	5,627	+ 12.0
Germany	98,400	78,990	+ 24.6
Great Britain	64,556	48,105	+ 34.2
Netherlands	3,311	2,611	+ 26.8
Norway	1,540	1,614	- 4.6
Sweden	424	406	+ 4.4
Switzerland	5,469	5,714	- 4.3
Total	**180,000**	**143,067**	**+ 25.8**

Germany is in good company, however. Private insolvencies show an even sharper rise in Great Britain (a jump of 34.2 percent to 64,556 applications), and are now about 30 percent higher than during the recession at the beginning of the 90s. British households are deeper in debt than ever before. In June 2005, the Bank of England warned that loans to private households have now risen, on an annualized basis, to 150 percent of available income. There are a number of factors that have led to an expansion of private indebtedness. Since the Bank of England went independent, the time of extreme swings in the economic cycle and in interest rates is over. Compared to earlier periods, low nominal and real interest rates mean favourable credit terms. Unemployment is down, and the British standard of living has risen. This has enticed consumers into running up higher debts, and has led banks to grant their customers more credit cards and unsecured loans. While the debt volume was expanding, the savings rate of private citizens sank to 4.2 percent in 2004 – its lowest level since 1963, the first time the savings rate was calculated.

Costly consumption boom

The only countries to report declines in private insolvencies are Norway (down 4.6 percent to 1,540 cases at present) and Switzerland (down 4.3 percent to 5,469). The total volume of insolvencies of private individuals in the seven countries surveyed adds up to 180,000 cases, 25.8 percent higher than just a year ago and well above the 147,000 figure for corporate insolvencies in the EU-17 states.

■ 3 Insolvencies in Germany

In 2004, strong export demand had made the German economy grow by 1.6 percent, a significant improvement over the year before, but in 2005 the development was less favourable. Growth – at 0.9 percent in real terms – was only moderate and was fuelled mainly by foreign trade, with domestic demand rising only slightly. This is how the Federal Office of Statistics (destatis) summarized the year as a whole in a report published in mid-January 2006.

But in the second half of the year, there was a trend to greater optimism. Since November, the business climate index of the ifo institute in Munich has improved significantly, while the consumer survey run by the EU Commission has been showing steady improvement since July.

Corporate insolvencies down …

Table 4: Insolvencies in Germany

■	2005	2004	Change in %
Total	136,300	118,260	+ 15.3
Companies	37,900	39,270	- 3.5
Private individuals	98,400	78,990	+ 24.6

The number of corporate insolvencies in 2005 also gives grounds for hope: the total fell for the second year in a row, by 1,370 cases to 37,900, a decline of 3.5 percent. But overall, including private individuals and over-indebted estates, the total rose to an all-time high of 136,300 cases. 66,400 consumers were affected, an increase of 35.2 percent from the year before. Other insolvencies – the formerly self-employed, over-indebted estates and associations and foundations – reported a more moderate climb, with the figure up 7.1 percent to 32,000.

… personal insolvencies increasing rapidly

In contrast to the past few years, Western Germany posted a decline in corporate insolvencies for the first time: company bankruptcies decreased in 2005 by 4.6 percent, to 28,700 cases. The year before 30,080 businesses were affected. Corporate insolvencies in Eastern Germany, on the other hand, rose again

slightly, by 0.1 percent, after two years of declining figures. In all, 9,200 companies in the new federal states filed for bankruptcy, ten more than in 2004.

The damage caused by insolvencies in 2005 added up to 37.5 billion euros, 1.9 billion lower than the year before. Figures were also down for the number of jobs lost to insolvencies. 563,000 workplaces were threatened or eliminated by the insolvency of the employer concerned, a decline of 6.9 percent.

■ 4 Financing

There are more than 20 million small and medium-sized enterprises (SMEs) in the EU; they can be seen as the backbone of European business. Companies have various ways of obtaining the funds that they need to finance investments and ongoing business operations. The most important financing instruments for SMEs are working capital loans, current account overdrafts and trade credits. A hybrid instrument for corporate financing, still relatively new in Europe, is mezzanine capital, which is slowly gaining in importance alongside leasing and factoring. However, there is no chance in the foreseeable future that it will displace bank loans as the prime source of outside finance.

House bank Europe-wide

In the past, firms in most European countries – with the exception of Great Britain – have tended to depend heavily on credit to finance their operations. One result of this is that alternative forms of outside financing for SMEs have developed only slowly, and that the equity ratio – especially in Germany – is relatively poor. Among German SMEs it averages 7.5 percent, and among medium-sized German corporations it is 16 percent, both of which are far below the average in the eurozone (around 35 percent) and the USA (around 45 percent).

Table 5: Financing entities used by SMEs

■	In percent
Banks	79.0
Leasing companies	24.0
Public business promotion bodies	11.0
Private investors	7.0
Private financing companies	4.0
Venture capitalists	2.0

Multiple answers possible; source: European Commission

In September 2005 the European Commission investigated access to sources of financing for SMEs in the European Union, surveying some 3,000 entrepreneurs in the member countries about their experiences. The responses produced the expected result: banks are the main source of financing for 79 percent of small and medium-sized enterprises. However, in Finland, this was true of only 52 percent of the SMEs surveyed. In Ireland and Austria, on the other hand, it applied to 91 and 92 percent of businesses respectively.

Questioning about the various types of financing revealed some surprising results. For example, 71 percent of German firms indicated that they use leasing. The corresponding figures in Austria and Sweden were 65 percent and 63 percent. In contrast, leasing plays only a subordinate role in Luxembourg (23 percent) and Finland (27 percent). The European average for the use of leasing as a form of financing is 51 percent.

Financing through leasing and overdrafts

Current account overdrafts play a major role especially in Denmark and Ireland. 83 percent of Danish and 81 percent of Irish companies use overdraft facilities for short-term financing. In contrast, the Swedes (13 percent), the Greeks (15 percent) and the Finns (17 percent) make use of this financing option only rarely. Overall in Europe, current account overdrafts are used by 50 percent of the firms surveyed.

Loans with a maturity period of more than three years are used by 45 percent of all SMEs in the EU. In

France and Belgium the figures are higher, at 58 percent and 57 percent respectively. In Great Britain, on the other hand, only 28 percent of firms have loan obligations.

Table 6: Payment conduct in Europe in days

■	Payment terms	Payment delay	Total
Italy	67 (66)	22 (21)	89 (87)
France	47 (47)	11 (12)	58 (59)
Great Britain	33 (32)	21 (22)	54 (54)
Belgium	35 (38)	15 (18)	50 (56)
Switzerland	25 (26)	18 (17)	43 (43)
Austria	29 (29)	12 (14)	41 (43)
Netherlands	25 (26)	15 (16)	40 (42)
Germany	26 (26)	14 (16)	40 (42)
Sweden	28 (27)	9 (8)	37 (35)

( ) = 2004

Supplier credits continue to be one of the most important sources of short-term financing for SMEs in Europe – and one of the most expensive. European companies often face severe liquidity problems because of delayed payments. The Italians in particular allow themselves ample time to pay their bills. On average it takes nearly three months for payments to be received (89 days; previous year: 87 days). Bills are also paid relatively late in France (58 days; previous year: 59) and in Great Britain (54 days; previous year: 54 days). The picture is different in Sweden, where invoices are paid within 37 days on average (previous year: 35 days).

Germany's standing is relatively good, with payments received on average after 40 days, but a look at the individual main segments of the economy reveals great differences. For example, 2.9 percent of customers in the service sector take more than 90 days to pay their bills. In construction the figure is 2.4 percent, while in the field of commerce it is only 1.7 percent.

The goal of the heads of state and government of the EU member nations is to "make the European Union

the most dynamic knowledge-based economic region in the world" (Eurostat). To that end the EU has set up special programmes to make it simpler for SMEs to participate in EU-supported research and innovation projects, and to make financing easier for them as well. The "Multi-Year Programme for Enterprises and Entrepreneurship", funded by the EU with 450 million euros, which was conceived especially for small and medium-sized firms, has the following goals:

- To increase the growth and competitiveness of businesses
- To promote entrepreneurial initiative
- To simplify and improve the administrative and regulatory environment for firms
- To improve the general financial conditions of businesses, especially for SMEs
- To simplify access by companies to the support services, community programmes and networks, and to improve their coordination

Public loans

The European Investment Bank for example grants global and individual loans. Global loans are intended primarily for firms with fewer than 500 employees and sales of at most 75 million euros, and are granted to intermediary financial institutions in the form of credit lines. Loans of up to 12.5 million euros are granted, to finance a maximum of 50 percent of the investment costs. For company projects in excess of 25 million euros the European Investment Bank can grant individual loans directly. It is hoped that this promotion of credit will contribute to greater stability among the European SMEs.

5 Insolvencies and the economy

In contrast to the economy in the USA, economic activity in the eurozone was extremely restrained in the first half of 2005. In the second quarter the seasonally adjusted GDP rose by 0.3 percent in real terms compared to the quarter before (after an increase of 0.4 percent in the first quarter). The index of industrial

production did not show any increased dynamism until August. But in the autumn the surveys – especially in Germany, Italy and France – pointed to an impending recovery in the eurozone, according to Vienna's WiFO Institute in its November report. The increased optimism in regard to production expectations in the final months of the past year was probably due to a surge in foreign demand, since assessments of the export order situation picked up around the same time.

Insolvencies destroy jobs

The most recently published average unemployment rate in the EU was 8.5 percent. Germany was in fourth place with an unemployment rate of 9.3 percent, after Poland (17 percent), Slovakia (16 percent) and Greece (10.1 percent).

Table 7: Insolvency-related unemployment in Europe

■	Job losses (in millions)
1999	1.4
2000	1.1
2001	1.4
2002	1.6
2003	1.7
2004	1.6
2005	1.5

The number of employees whose jobs were threatened because their employer had to file for bankruptcy declined by 100,000 to 1.5 million – parallel to the falls in corporate insolvencies. This bears out the thesis that it is small and medium-sized businesses which are most prone to insolvencies.

Table 8: Contributions to the insolvency volume by the key economic sectors in Europe in 2005 (average)

■	Contribution to insolvency
Manufacturing	9.5 (10.2)
Construction	19.8 (18.6)
Commerce	31.6 (26.5)
Services	39.2 (44.7)

In percent, ( ) = 2004

The service sector typically contributes the largest share to the insolvency volume in Europe, but last year its contribution decreased by 5.5 percentage points to 39.2 percent. The proportions of the total accounted for by commerce and construction grew correspondingly: by 5.1 percentage points to 31.6 percent in the one case, by 1.2 percentage points to 19.8 percent in the other. Manufacturing, in contrast, continued to profit from strong business activity, and was able to reduce its share of the insolvency volume – as it had the prior year as well. Only 9.5 percent of all corporate insolvencies come from manufacturing firms – in 2004 the figure was 10.2 percent.

Construction and commerce with larger share of insolvency total

Table 9: Insolvencies in the key economic sectors in 2005

■	Manu-facturing	Con-struction	Com-merce *	Services
Belgium	8.1 (7.9)	14.7 (13.9)	53.9 (33.7)	23.3 (44.6)
Denmark	11.9 (8.6)	15.5 (11.1)	38.1 (42.6)	34.5 (37.7)
France	8.9 (10.7)	21.4 (23.8)	35.0 (25.2)	34.8 (40.3)
Germany	7.9 (8.3)	19.7 (20.2)	24.7 (23.8)	47.7 (47.7)
Great Britain	17.3 (18.5)	24.0 (17.2)	22.1 (22.7)	36.6 (41.7)
Netherlands	11.5 (12.1)	13.3 (13.4)	29.5 (32.1)	45.7 (42.4)
Norway	10.1 (10.0)	11.0 (10.9)	47.4 (34.3)	31.5 (44.8)

*) including hotels, restaurants and cafés, figures in percent ( ) = 2004

A more precise breakdown of insolvencies by economic sector in the individual countries reveals structural differences, often quite substantial. Germany has the smallest contribution of insolvencies from the manufacturing sector, with only 7.9 percent (previous year: 8.3 percent). In Great Britain, on the other hand, 17.3 percent of all insolvencies come from this sector, although here too the proportion decreased, by 1.2 percentage points.

The largest percentage share of failures from the construction industry is recorded in Great Britain, where almost one insolvency in every four (24.0 percent; previous year: 17.2 percent) comes from this key economic sector. In Norway the figure is only 11.0 percent (previous year: 10.9 percent).

The insolvencies registered in the field of commerce include the segment hotels, restaurants and cafés (horeca). In Belgium over half of all insolvencies last year were in commerce (53.9 percent; previous year: 33.7 percent). In Great Britain, by contrast, this sector does not play such a sizeable a role. Only 22.1 percent of bankruptcies come from commerce, representing a year-on-year decline of 0.6 percentage points.

Differences in the rates for various sectors

In Germany almost half of all corporate failures occur in the service sector: 47.7 percent (previous year: 47.7 percent). In Belgium, the picture is different: only 23.3 percent (previous year: 44.6 percent) of business bankruptcies can be allocated to the service sector.

■ 6 National reports

6.1 Great Britain

At the beginning of 2005 the unemployment rate in Great Britain was at a historic low of 4.7 percent, while the inflation rate was 1.6 percent. Nevertheless, towards the end of the year, Europe's economic powerhouse ran out of steam; Chancellor of the Exchequer (Finance Minister) Gordon Brown had to more or less halve his growth forecasts for 2005, to 1.75 percent. This slow-down was due primarily to factors connected with the economic cycle. As already noted, the mainstay of the British economy is private consumption. Now, though, many families have reached the limits on their credit cards and have to hold on to their money. The boom in property prices also came to a standstill at the end of the year, because many people simply could no longer afford a home of their own. There are warnings that the property bubble could burst.

Table 10: Insolvencies in Great Britain

■	2005	2004	Change in %
Total	74,900	60,918	+ 23.0
Companies	10,344	12,813	- 19.3
Private individuals	64,556	48,105	+ 34.2

The high level of private consumption of the British reveals its reverse side in the immensely increased number of private insolvencies. The volume of over-indebted consumers rose by more than a third (34.2 percent) – and nearly 65,000 persons filed for bankruptcy.

Greatest increase in private insolvencies

The corporate insolvency picture was very different, with a year-on-year decline of 19.3 percent, from 12,813 to 10,344.

6.2 Italy

Corporate insolvencies in Italy rose only moderately in 2005, by 2.8 percent after an increase of 2.3 percent in 2004.

After industrial production declined in Italy by 0.4 percent in 2004, in 2005 a drop of around half a percentage point is expected for the fourth time in a row. So the growth in gross domestic product in 2005, anticipated at 0.3 percent, may in fact hover close to the zero line. Conspicuous points of weakness in the Italian economy are the reform backlog, stagnating consumption, and the timid expansion of investment. Another factor is Italy's industrial structure, with its emphasis on the production of consumer goods, which (according to the economic report of Bayerische Landesbank) makes the country especially sensitive to competition from Asian suppliers.

Table 11: Corporate insolvencies in Italy

■	2005	2004	Change in %
	11,000	10,700	+ 2.8

Since the introduction of the euro the country has felt its structural problems more acutely than ever before. In the post-war years Italy again and again staved off international competition by accepting inflation and devaluing the lira. At the same time, the public sector piled up an enormous mountain of debt. When Italy joined the eurozone, that policy had to be abandoned. As a result, the relative rise in prices in recent years

has meant that price levels for consumer goods are now higher in Italy than in other large EU countries, while at the same time average incomes are lower than those in the other two big EU states, Germany and France.

6.3 Spain

Reform of insolvency law must succeed

The Spanish economy, with a growth rate of 2.7 percent, continues to outdo the EU average. Growth is fuelled mainly by private consumption and construction – driven by rising wages, low real interest rates and enormous public investments in the country's infrastructure. But the contribution of foreign trade to GDP is negative, since Spanish exports continue to lag far behind imports.

The inflation rate in 2004 was 3.1 percent. Despite notable successes in job creation, Spain's 11 percent unemployment rate continues to be one of the highest in the EU. With a total volume of 57.3 billon euros in structural subsidies (2000-2006), the country is the largest net recipient of aid from the EU. Average income has now reached 86 percent of the mean for the EU-15 states (i.e. excluding the countries which joined in 2004).

Table 12: Corporate insolvencies in Spain

■	2005	2004	Change in %
	549	561	- 2.1

The insolvency figures for Spain are not really comparable with those elsewhere, due to the special cultural and legal circumstances mentioned earlier. It is hoped that the reform of insolvency legislation will help to establish a more regulated form of market exit, closer to that in other countries.

6.4 France

France registered over 42,000 insolvencies, the highest number in any of the EU-17 countries. But the volume actually grew by only a moderate 5.1 percent.

The most prominent victim of the flood of insolvencies in 2005 was the luxury shoe manufacturer Charles Jourdan.

Early entry into insolvency proceedings

In France, extensive control mechanisms take effect as soon as a company finds itself in financial difficulties. It could well be that the official notification requirements result in higher insolvency numbers, because they make it difficult for company owners to keep a crisis secret or delay the process of filing for insolvency until the last minute.

Furthermore, the principal goal of French insolvency legislation – in contrast to that in Germany – is to preserve the company concerned and the relevant workplaces. Ensuring the best possible satisfaction for creditors is not a top priority.

Table 13: Corporate insolvencies in France

■	2005	2004	Change in %
	42,874	40,776	+ 5.1

Fuelled chiefly by private consumption, the French economy experienced a gratifyingly dynamic development in 2004, suffering a mild downturn only in the third quarter because of the rise in world market prices for oil and steel and the weakness of the dollar. For 2005, the forecast was a growth rate of about 2.2 percent. The inflation rate of 2.1 percent in 2004 was slightly higher than that in the eurozone as a whole, but this was due mainly to a one-off effect, the substantial increase in tobacco tax. For 2005, inflation was expected to be 1.6 percent.

The marked recovery of the economy, which was expected to continue in 2005, is attributed primarily to a perceptible increase in domestic private demand. Additional economic impetus comes from investment activity by corporations, which are again paying out money to acquire replacement goods that will increase productivity. Exports have made only a smallish contribution to growth.

■ 7 The eastern expansion of the EU: New member states

Corporate insolvencies in the new member states of the European Union numbered 18,293 at the end of 2005 (previous year: 18,518), representing a slight fall of 1.2 percent. The greatest reductions were posted by Latvia (down 34.5 percent to 521) and Poland (down 30.4 percent to 798). On the other hand, business failures increased in both Lithuania and Slovenia (up by 8.3 percent to 767 and by 7.0 percent to 1,800, respectively.

Table 14: Corporate insolvencies in Eastern Europe (2003 – 2005)

■	2005	2004	2003	Change 2004/05 in percent
Czech Republic	3,800	3,643	3,918	+ 4.3
Estonia	450	436	445	+ 3.2
Hungary	7,957	7,804	7,693	+ 2.0
Latvia	521	796	1,339	- 34.5
Lithuania	767	708	611	+ 8.3
Poland	798	1,147	1,076	- 30.4
Slovakia	2,200	2,300	2,500	- 4.3
Slovenia	1,800	1,684	1,555	+ 7.0
Total	**18,293**	**18,518**	**19,137**	**- 1.2**

The data on corporate insolvencies in the new member states of the EU cannot yet be considered as solid and meaningful as the figures for Western Europe. All of these countries now have regulations intended to govern the market exit of insolvent companies, but the lack of relevant experience and the absence of effective instruments for enforcing these regulations, coupled in some cases with corruption, a shortage of financial resources and/or inadequate controls form barriers to the smooth conduct and registration of insolvency proceedings.

Liquidation preferable to insolvency

This is clearly evident from the development and volume of corporate insolvencies in Poland, where the insolvency rate is given as just two bankruptcies per 10,000 companies. The economic situation in Poland

is still distinguished by the political transformation in Eastern Europe and the results of accession to the EU. GDP has grown very vigorously in recent years – with a growth rate of 5.3 percent in 2004 and an estimate by the EU Commission of 4.4 percent for 2005, the increase is far higher than that in Germany. The primary causes of this are the rise in exports due to improved access to European sales markets since joining the EU and the greater level of direct investment from abroad. On the other hand, though, the inflation rate – at 3.6 percent – is high, and so too is the budgetary deficit (4.8 percent), while unemployment is massive, with a rate of 18.8 percent. This striking contrast is partly the result of Poland's structural problems, such as the still relatively high proportion of people employed in agriculture and the disparity between municipal centres and rural regions where economic development is concerned. Furthermore, Poland is struggling with a birth deficit coupled with high rates of emigration.

Table 15: Insolvency ratios in individual Eastern European countries

■	Insolvencies per 10,000 companies
Poland	2
Czech Republic	42
Hungary	62
Slovakia	79
Latvia	103
Lithuania	120
Estonia	133
Slovenia	196
Average overall	**38**

__More insolvencies as the result of high growth?__

In the new member states, the average insolvency ratio – 38 corporate failures for every 10,000 companies – is significantly lower than that in the Western European countries, chiefly because of the low number of insolvencies posted in Poland. The highest relative insolvency density is exhibited by Slovenia, with 196 insolvencies per 10,000 businesses. The Slovenian legal system offers greater certainty and predictability than that in the other Central and

Eastern European countries, and creditor protection is relatively good. The country's economy is organised on market economic principles, although the economic role of the state is greater than in the other transformational countries. Slovenia's economic policy is strongly export-oriented. Per capita GDP now matches that in Portugal and Greece.

In 2004 the unemployment rate reached an annual average of 6.4 percent. There are great regional differences, however, and a concentration of unskilled and older workers. The inflation rate is still high, at 3.6 percent; reducing inflation is a key priority for the Slovenian government. The country's declared goal is to be in a position to introduce the euro in 2007.

Slovakia: A success story

Slovakia deserves special mention. This little country has evolved from a tail-ender to a pace-setter. It has carried out a remarkable series of radical reforms, such as the introduction of a universal tax rate of 19 percent and the simultaneous abolishment of all subsidies and write-down options. All of this has been achieved despite the fact that the country is ruled by a minority government – one that has been frequently rocked by scandals. At the same time, inheritance, gift and land acquisition taxes were eliminated, in order to motivate entrepreneurs to invest. The rate of economic growth in Slovakia is five percent; the July figure for unemployment was down to 15.2 percent, after 18.1 percent the year before. The number of insolvencies has dropped for the third year in a row: last year a total of 2,200 businesses filed a petition for bankruptcy, a decrease of 4.3 percent.

There is criticism, though, that the burden of the extensive reforms in Slovakia is being borne primarily by the weakest members of society and that the government is actually widening the gap between the two parts of the country (poverty in the east, wealth in the west).

■ 8 Insolvencies in Japan and the USA

8.1 Japan

The Japanese economy has been in a deflationary spiral for 15 years. Now, though, the signs of change are on the increase. According to the Japanese central bank, in August 2005 the commercial banks issued more loans than in the same period the year before – the first time for ages that this has happened.

Domestic demand has developed into a driving force for economic recovery in Japan. While companies like car-makers Toyota are investing their profits in new factories and higher salaries, consumers are again spending more money.

Expenditure on private consumption, which accounts for more than half of economic activity in Japan, has been rising – by 0.3 percent in the third quarter of 2005, according to the Süddeutsche Zeitung. At the same time company investments, which contribute around 15 percent to total economic activity, have risen by 0.7 percent in real terms.

In line with this pattern are the Japanese insolvency figures, which exhibit a clear downward tendency at minus 28.1 percent. All-in-all the economy suffered a total of 9,942 corporate insolvencies – in 2004 there were 13,837.

Table 16: Corporate insolvencies in Japan

■	2005	2004	Change in %
	9,942	13,837	- 28.1

Japan is recovering

The Bank of Japan has stated that economic growth will help to end the decline in prices by the end of March 2006. This should enable the bank to initiate a change of direction in its monetary policy, which up to now has been aimed at fighting deflation, and not pump as much money into the economy as before. Oil prices continue to be a source of uncertainty. But the government expects the economic recovery to continue, pulled along by the private sector.

8.2 USA

In the field of the economy, the USA is generally seen as a model – a nation able to generate exemplary dynamism with only a minimum of government intervention. Evidence of this is provided by an unemployment rate of just five percent and an economic growth rate of more than three percent per year.

But the other side of the coin is that last year more than 1.8 million Americans declared bankruptcy, an increase of 18.4 percent. Stagnating wages are making it more and more difficult to meet the costs of education, provision for healthcare and retirement, and day-to-day consumption. According to reports in the American press, the total indebtedness of credit card holders in the USA has nearly doubled in ten years, to 838 billion dollars. Critics argue that banks do not take sufficient care about issuing credit cards to their customers, who are then driven into debt. Around 60 percent of credit card holders have a deficit on their accounts, often one that then gradually builds up. In such cases, the interest charged by credit card companies can be as high as 22 percent, making the situation even worse for the individuals concerned.

Fear of big insolvencies

On the corporate side, the recent bankruptcies of Delta Airlines and Northwest Airlines and the insolvency of Delphi, the world's second-largest automotive parts manufacturer, make the situation of the aviation and automobile industry clear. The problems facing General Motors and Ford are all too evident – and could have far-reaching consequences for the entire country. “The big industrial concerns are now paying the price for the social benefits and concessions they have been granting their well-organized employees since the 1970s – benefits they can no longer afford", claimed the Süddeutsche Zeitung on October 19, 2005. Numerous companies are going bankrupt in order to be able to offload the costs of employee healthcare and pensions onto the state.

On October 17, far-reaching changes in US bankruptcy law came into effect. These make it much more difficult for companies and private individuals to rid themselves of their debts, and also force business companies to either restructure quickly in order to end the insolvency proceedings or else to go into liquidation. The new laws will make US companies more hesitant in the future about misusing the bankruptcy courts as a management instrument.

The slight increase in corporate insolvencies in the USA (up 2.1 percent to around 35,000) can be explained by the tightening of the law in October – before the changes came into effect, considerable numbers of distressed companies took advantage of Chapter 11 and the generous scope for reorganisation which it then still offered.

Table 17: Insolvencies in the USA

■	2005	2004	Change in %
Total	1,885,872	1,597,462	+ 18.1
Companies	35,033	34,317	+ 2.1
Private individuals	1,850,839	1,563,145	+ 18.4

In the future, consumers will no longer be able to benefit from Chapter 7 of the American bankruptcy law, which granted comprehensive release from debts in return for the debtor turning over a large part of his assets to his creditors. The rules of Chapter 7 are so generous that the debtor does not even have to prove conclusively that he really is insolvent. From now on, the rules to be applied are those in Chapter 13, which lay down that debt relief is only possible if the debtor agrees to extensive repayments. In addition, individual cases will be examined more closely.

■ 9 Summary

For the first time in four years, the number of business collapses in the European Union plus Switzerland and Norway shows a decrease. The total fell by two percent to 147,239 compared with slightly over 150,000 (150,312) the year before.

Six of the 17 Western European countries surveyed still show a rising number of insolvencies. The greatest rate of increase occurred in Austria. The volume of insolvencies in the Alpine republic rose by 15.3 percent to a total of 7,299 cases. Some 25,000 employees were affected.

Greece also reports a double-digit increase. The corporate bankruptcy volume grew by 10.9 percent to a total of 640 cases. Higher business insolvency figures are also posted by Portugal (up 5.7 percent to a total of 3,300), France (up 5.1 percent to 42,874), Italy (up 2.8 percent to 11,000) and Luxembourg (up 0.5 percent to 668).

The biggest decline was reported by Ireland: The Emerald Isle was able to reduce its volume of insolvencies by 21.5 percent to 252 cases. That is just slightly more than the figure reported by the city of Mülheim an der Ruhr in Germany (240 insolvencies in 2005). The countries with the second and third largest decreases are Great Britain (down 19.3 percent to 10,344) and Norway (down 14.5 percent to 2,293).

For the second year in a row, France had the largest absolute volume of corporate collapses: the 2005 figure was 42,874, representing an increase of 5.1 percent.

The highest relative insolvency rate (obtained by comparing the number of insolvencies to the number of businesses that exist in the country concerned) is also exhibited by Austria: In 2005, 288 out of every 10,000 enterprises had to face the bankruptcy judge. The average for Europe as a whole was 77 per 10,000 companies. Germany ranks in the lower middle range, with 130 insolvencies per 10,000 companies.

The number of personal insolvencies recorded for the countries Austria, Germany, Great Britain, the Netherlands, Norway, Sweden and Switzerland rose by a substantial 25.8 percent to 180,000 persons (previous year: 143,067). Increases were registered in particular by Great Britain (up 34.2 percent to 64,556,

the Netherlands (up 26.8 percent to 3,311) and Germany (up 24.6 percent to 98,400). Decreases in personal insolvencies were exhibited only by Norway (down 4.6 percent to 1,540) and Switzerland (down 4.3 percent to 5,469).

In Germany, corporate insolvencies have now fallen for two years in a row: 37,900 companies had to file for bankruptcy in 2005 – a decline of 3.5 percent, or 1,370, on the prior year. But overall, insolvencies rose to an all-time high of 136,300 cases of corporate and personal bankruptcy and over-indebted estates. 66,400 consumers were affected, an increase of 35.2 percent on the year before. On the other hand, the increases in what are called other insolvencies – the formerly self-employed, over-indebted estates and associations and foundations – are relatively moderate, up 7.1 percent to 32,000.

The number of employees in the EU-17 countries whose jobs were threatened because their employer had to file for bankruptcy declined – in parallel to the fall in corporate collapses – by 100,000 to 1.5 million. The service sector contributed the largest share of the insolvency volume: 39.2 percent of all insolvencies in Europe come from this key economic sector (previous year: 44.7 percent). One insolvent company in every five comes from the construction sector (2005: 19.8 percent; 2004: 18.6 percent), while commerce (wholesale and retail) accounts for 31.6 percent (previous year: 26.5 percent). Manufacturing, in contrast, plays only a subordinate role: Only one in every ten corporate bankruptcies (9.5 percent; previous year: 10.2 percent) belongs to this sector.

Corporate bankruptcies in the new member countries of the EU have now been published for the third time in succession. It must be kept in mind, however, that the meaningfulness of these figures cannot yet be compared to those for Western Europe. Corporate insolvencies in the new member states of the European Union numbered 18,293 at the end of 2005 (previous year: 18,518), down slightly by 1.2 percent. The greatest decreases in bankruptcies were posted

by Latvia (down 34.5 percent to 521) and Poland (down 30.4 percent to 798). On the other hand, business failures increased in Lithuania (up by 8.3 percent to 767) and Slovenia (up by 7.0 percent to a total of 1,800).

Insolvencies in Japan exhibit a significant downward trend, with a fall of 28.1 percent: just under 10,000 companies (9,942) faced the bankruptcy courts in the past year, compared to 13,837 in 2004. In the USA, both corporate and personal insolvencies show increases: 35,033 insolvent companies represent an increase of 2.1 percent. The rise in the volume of personal bankruptcies was much greater. There were 1,885,872 cases of personal bankruptcy, representing an increase of 18.1 percent over the year before.

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