

Insolvencies in Europe

■ 2006/07

A survey by the
Creditreform Economic
Research Unit

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■ 1 Introduction

In the course of 2006, the upswing in the industrialized countries lost steam somewhat, although world economic growth remains robust. The major economic regions developed in different ways. Whereas in the USA and Japan, the utilization of overall economic capacities fell, in Europe the upswing consolidated noticeably.

The European Commission expects overall growth of 2.8 percent in the EU in 2006, with the eurozone registering 2.6 percent. According to preliminary figures, the economy in Germany has picked again; with gross domestic product growth of 2.5 percent in real terms, the country is now only just below the average of the EU-25. The year before, Germany recorded a growth rate of only 0.9 percent, making it one of the tail-enders in the EU.

Broad upturn

The decisive factors fuelling greater growth in Europe are an ongoing rise in domestic demand, particularly in the field of capital investment, which in the first half increased by an annualized 6 percent, and the continued expansion of the global economy. Consumer expenditure has been climbing gradually as the result the improved situation in the labour market, while the world economy boosted exports.

For the development of insolvencies in Europe, Japan and the USA surveyed in this report, the factors that matter, though, are not just economic or financial but also concern legislative frameworks and cultural specifics. This is Creditreform's 17th annual report on the insolvency situation in a total of 27 countries.

■ 2 Insolvencies in Western Europe in 2006

2.1 Corporate insolvencies

For the second year in succession, the number of corporate insolvencies in the EU-17 countries fell. The total declined to 141,448 cases, as against 154,510 in 2005, equivalent to a drop of 8.5 percent.

In the period 2002-2004, business failures rose to a peak of more than 155,000, but since 2004 the movement has been in the opposite direction.

Table 1: Corporate insolvencies in Western Europe

■	2006	2005	2004	2003	2002	Change 2005/06 in percent
Austria	6,854	7,136	6,328	5,643	5,281	- 4.0
Belgium	7,455	7,878	7,836	7,593	7,222	- 5.4
Denmark	1,987	2,497	2,620	2,506	2,469	- 20.4
Finland	2,350	2,278	2,385	2,769	2,885	+ 3.2
France	38,369	41,930	40,776	38,296	37,987	- 8.5
Germany	31,300	36,850	39,270	39,470	37,620	- 15.1
Great Britain ¹	13,777	13,462	12,813	14,815	17,094	+ 2.3
Greece	520	580	577	480	489	- 10.3
Ireland	296	327	321	346	379	- 9.5
Italy ²	15,900	17,150	17,500	16,000	16,000	- 7.3
Luxembourg	634	682	665	655	695	- 7.0
Netherlands	6,052	6,780	6,648	6,386	6,489	- 10.7
Norway	1,913	2,175	2,683	3,084	2,603	- 12.0
Portugal	3,400	3,300	3,123	2,980	2,092	+ 3.0
Spain	849	869	561	646	629	- 2.3
Sweden	5,264	5,865	6,588	7,099	6,892	- 10.2
Switzerland	4,528	4,751	4,955	4,539	4,002	- 4.7
Total	141,448	154,510	155,649	153,307	150,828	- 8.5

At present, only three of the 17 countries surveyed report a rise in insolvencies; in each case the increase is in the moderate single-digit percentage range. The biggest growth in the total was registered in Finland,

¹ Due to an editorial error, part of last year's survey contained an incorrect figure for 2005 (10,344).

² Change in source of data: Creditreform Italy no longer obtains its data from the Ministry of Justice but from the register of companies (where the insolvency statistics also include company partners who are natural persons).

with an increase of 3.2 percent to 2,350 affected companies. It was followed by Portugal, with 3,400 business failures, equivalent to a rise of 3.0 percent. Great Britain also posted a higher volume: last year 13,777 companies there ended up in the bankruptcy courts, an increase of 2.3 percent (prior year: 13,462).

Finland is a highly developed industrial country, with GDP growth in 2006 estimated at 4.9 percent. Thanks to growing foreign trade and broadly based domestic demand, the country's economy has been evolving positively. The unemployment rate is currently 7.9 percent. In 2006, the budget totalled 39.6 bn euros and posted a slight surplus, despite the 2005 reform of income and corporation tax. The financial situation of Finnish municipalities deteriorated because of higher costs for public services (health/social welfare). As Table 2 indicates, the insolvency ratio in Finland, with 97 insolvencies for every 10,000 active companies, is well above the EU average of 65.

Problems on the fringes of Europe

Portugal is another of the three countries with a slight upward insolvency trend, but its ratio of 27 failures for every 10,000 firms is considerably below the EU-17 average. Portugal is currently undergoing a difficult phase in its economic development. Following a temporary recovery, which was boosted by the European soccer championships, in the first half of 2004, the country then dropped back into recession in the second half. In 2005, according to provisional calculations, economic growth was only 0.3 percent. For 2006, GDP is expected to increase by a maximum of 1.0 percent. In particular, unemployment will continue to increase, since a good many companies, for example in the garment sector, whose activities in Portugal were based primarily on the low labour costs, have indicated that they are relocating production to other, less expensive countries.

Economic growth in Great Britain in 2006 is estimated at 2.6 percent. The dynamism of the British economy is characterized essentially by a strong services sector, with financial services in particular making an above-average contribution to growth. The country's high-

priced property market (see also Chapter 5.2) has been cooling down, and this coincided with a weakening of consumer demand. Despite the moderate increase in the total volume of corporate insolvencies, though, the insolvency ratio, at just 69 for every 10,000 companies, is more or less on a par with the European average.

Table. 2: Insolvency ratios in the individual Western European countries

■	Insolvencies per 10,000 companies
Spain	3
Greece	7
Italy	26
Portugal	27
Ireland	30
Norway	60
Great Britain	69
Finland	97
Sweden	99
Belgium	105
Germany	106
Denmark	109
Netherlands	124
Switzerland	135
France	149
Austria	190
Luxembourg	239
Total	65

Relative incidence of insolvency

The biggest fall in corporate insolvencies was posted in Denmark, with a drop of 20.4 percent from close to 2,500 the year before to just under 2,000 affected companies (more or less equal to the total for the city of Cologne, 1,800). In terms of key economic indicators, Denmark is one of the European leaders and is currently enjoying a boom phase. Only just a few years ago, the country's growth tended to be low, but since 2003 it has picked up speed and in 2006 rose by 2.7 percent. Unemployment has been cut significantly and is now at the lowest level for 30 years. In 2006, the jobless total was just 127,000,

corresponding to 4.4 percent of the total labour force. In fact, Danish companies are increasingly complaining about the shortage of labour, particularly of skilled workers. Denmark has introduced a system called "flexicurity" (flexibility + security) and its labour market is one of the most resilient in Europe. There is, for instance, virtually no protection against dismissal, but the state safeguards citizens by means of high social welfare benefits.

Second place among the countries with the most marked decline in corporate insolvencies was Germany, where the number declined by 15.1 percent. Overall, 31,300 companies had to file for bankruptcy last year, as against 36,850 the year before. However, with 106 insolvencies for every 10,000 active companies, Germany is still above the EU-17 average of 65 (for further information see Chapter 5.1).

Germany stabilizing

The third country with the most significant fall in business failures was Norway. There, the total fell by 12.0 percent in the course of the year to 1,913 affected companies (2005: 2,175). The insolvency ratio, at 60 for every 10,000 companies, is also below the European average. The Norwegian economy is fundamentally different from that of other countries in Europe. Within just one generation, Norway has made a quantum economic leap as a result of exploiting its oil and gas reserves. After being one of the poorest Western European countries, it is now the world's third-largest oil exporter, with full employment and high current account and budgetary surpluses. It also has one of the biggest per-capita levels of GDP (2005: 51,500 euros). In 2006, Oslo became the world's most expensive capital city. Norway has bypassed the phase of comprehensive industrialization to develop into a services-oriented society, whose prosperity depends decisively on a unique mix of raw materials and resources (oil, gas, fish, timber).

The highest relative incidence of insolvency (number of active companies compared with the number of insolvencies) is reported by Luxembourg (239 for every 10,000 companies), Austria (190) and France (149). In

line with established tradition, Spain (with an insolvency ratio of 3) comes at the bottom of this list, but that has less to do with a flourishing economy than with non-functioning insolvency legislation for small enterprises (see Chapter 5.4).

Small businesses without insolvency

Just ahead of it in the list, with 520 insolvencies in total and an insolvency ratio of 7 for every 10,000 firms, is Greece, which is thus well below the EU average. This extremely low level of insolvencies is an indication that in Greece, just like in Spain – small and mini-firms in particular do not take advantage of the legal option of reaching an out-of-court settlement with their creditors; they simply close down business. The same basically applies to Italy and Portugal, the next two countries in the list.

Sweden has a high insolvency ratio (99 for every 10,000 companies). The Swedish economist Klas Buttwill explains this by the high proportion of bankruptcy applications filed by companies with no employees. In the statistics of other countries, such cases are generally classified as private insolvencies. This also helps to explain why Sweden has a notably low volume of personal insolvencies (see Chapter 2.2). The average insolvency ratio for the EU-17 states dropped last year from 77 to 65.

2.2 Private insolvencies

Whereas corporate insolvencies are in decline in Western Europe, the number of bankruptcy applications by private individuals has risen sharply. In those countries with debt-clearance procedures for consumers and which publish the relevant figures, private insolvencies last year increased by 30.7 percent. Overall, close to 257,000 private individuals went to the insolvency courts with the aim of obtaining debt relief. The list of countries is headed by Great Britain, with a rise of 47.2 percent, In second place comes Germany, with an increase of 22.1 percent to 121,800 affected individuals. Bucking the trend were the Netherlands (total down by 2.5 percent) and especially the two Scandinavian countries of Norway

Surge in private insolvencies

(down 24.7 percent to 1,077) and Sweden (down 15.4 percent to 385). However, as mentioned in the previous chapter, Sweden is a special case from the statistical angle, which helps to explain the low absolute number of personal insolvencies. Another factor in this connection is that up to now Swedish law has made it possible for applications for debt relief to be rejected if there are indications of irresponsible credit uptake on the part of the debtor. With effect from January 1, 2007, however, the relevant law was amended in response to criticism that the authority responsible for such rejections in Sweden had been taking frequent advantage of this option for "general preventive reasons". In the amended insolvency legislation, the option no longer exists.

Table. 3: Private insolvencies in Europe

■	2006	2005	2004	Change 2005/06 in percent
Austria	7,583	6,462	5,627	+ 17.3
Germany	121,800	99,720	78,990	+ 22.1
Great Britain	116,929	79,426	48,105	+ 47.2
Netherlands	3,227	3,311	2,611	- 2.5
Norway	1,077	1,431	1,614	- 24.7
Sweden	385	455	406	- 15.4
Switzerland	5,840	5,714	5,469	+ 2.2
Total	256,841	196,519	142,822	+ 30.7

When it comes to the relative incidence of private insolvency, the list is headed by Great Britain (20 insolvencies for every 10,000 inhabitants), followed by Germany with a ratio of 15. Outside Europe, it is only in the USA that the insolvency ratio (at 19 per 10,000 inhabitants) is higher than in Germany.

Table. 4: Private insolvency ratios in the individual Western European countries

■	Insolvencies per 10,000 private individuals
Sweden	0.4
Netherlands	2
Norway	2
Switzerland	8
Austria	9
Germany	15
Great Britain	20
Average	14

Despite the enormous increase, the registered volume of private insolvencies actually only represents the tip of the iceberg where over-indebtedness among consumers is concerned. This is shown by a look at the relative incidence of this phenomenon in the different countries. The definition of over-indebtedness used here is that a debtor will not be able to fulfil his total payment obligations in the foreseeable future and that he has insufficient assets to meet his day-to-day living requirements and cannot obtain further credit to do so.

Internationally, the worst over-indebtedness ratio (number of affected individuals compared with the total number of adult inhabitants) is reported by the USA, with 12.7 percent, equivalent to 26.4 million individuals. Next come Germany, with a ratio of 10.7 percent (7.2 million individuals), and Great Britain, with 7.6 percent (3.6 million persons). France, Sweden and the Netherlands have ratios of between three and four percent.

The high German over-indebtedness ratio is all the more worrying when one remembers that both Great Britain and the USA stand for an "open credit economy", in which consumer loans are regarded as an instrument to promote individual prosperity and to which access should be restricted as little as possible. In such countries, the insolvency procedure is seen as a means of restoring the functionality of the market.

Waiting for residual debt clearance

For this reason, the good-conduct periods in both countries (see Table 5) are relatively short. The granting of debt relief is regarded as a prerequisite for a desirable development: the renewed participation of the particular individual in the financial and credit market.

Table 5: Time required for residual debt clearance in different countries

■	Length of procedure / time when residual debt clearance is granted
Germany	6 years
USA	Procedure over in around two months
Great Britain	At the latest after 12 months
France	After a maximum of 24 months
Sweden	5-year procedure, can be abridged in individual cases
Netherlands	At least 3-year to maximum 5-year repayment plan

Source: Debt Report 2006

On the other hand are Sweden and the Netherlands, with their stronger roots in the concept of the welfare state. In both countries, protecting the individual in the case of blameless economic and social crisis takes precedence, as a matter of principle, over the matter of market regulation. This basically also applies to Germany.

Over-indebtedness affects primarily singles or single parents in low-paid jobs or with no jobs at all. Nevertheless, there are some significant differences in the structure of the social background of over-indebted private individuals in different countries. The average total debt in such cases in Sweden is 50,000 euros. This is very high when compared, for instance, with the figure in the Netherlands, at 17,000 euros. In Germany, the majority of over-indebted private households in the new federal states have total debts of under 10,000 euros; in the Western part of the country, the figure is between 10,000 and 25,000 euros. In Great Britain, the average level of debts is 26,800 pounds. The level of disposable income also reveals some marked differences. Affected persons in Great Britain have an

Varying levels of debt

average of 945 euros at their disposal, in the Netherlands the figure is just under 1,000, in Sweden it is 1,500 euros, and in the USA between 1,540 and 1,925 euros.

Where the reasons for over-indebtedness are concerned, there is little difference between the countries surveyed. It is caused in particular by unemployment, divorce, illness resulting in incapacitation, and taking on credit obligations which are too high in relation to the person's income. Often, the process of becoming over-indebted is gradual.

In the USA and, to a slightly lesser extent, in the UK, a prime cause of over-indebtedness is sickness and the associated costs of medical treatment and rehabilitation, which citizens in these countries frequently have to pay for, entirely or in part, from their own pockets. According to a Harvard University study published in February 2005, the costs of medical treatment were one of the main reasons for private bankruptcy in 46.2 percent of affected households.

Another factor is that credit card debt plays a far greater role in the USA than in Germany. In 2003, the average credit card holder in the USA had an unsettled account of 8,500 dollars. If monthly repayments are made at only the minimum permissible level (2 or 3 percent of the credit amount), this can lead to a debt "explosion". In Great Britain, where the interest charged on credit card debt is typically 17.9 percent, an open debt of 3,000 pounds would take 40 years (including interest and late payment penalties) to pay off if the repayment rate is just 2 percent of the sum.

Both the USA and Great Britain have what is called a secondary credit market. This largely unregulated market segment has arisen as a result of significantly weaker financial supervision and gaps in providing protection from extortionate rates of interest. The main group of people affected by this are low-income households without any access to the "good products" of the primary credit market. In the secondary market, they can obtain money only at extremely high interest

Scope for extortion

rates. Pawnshops in the USA, for instance, charge between 30 and 300 percent. In the UK, shady money lenders charge interest rates of between 100 and 500 percent.

The fact that the time required for residual debt clearance in France and the UK in particular is comparatively short has prompted ingenious individuals to come up with some surprising business ideas. The background is a German high court judgement in 2001 laying down that clearance obtained in any EU member state must be recognized in Germany. The advantage is obvious: this enables German consumers to obtain relief from their debts in 18 to 24 months, instead of having to wait 6 years. The crucial point is that, in France, for instance, the individual concerned has to produce evidence that the "focus of his life" is in that country. This means having a home or a job in France and living there on a permanent basis for at least six months. Since there is no registration period, proof has to be furnished in the form of rental payments and telephone or heating or electricity bills. German firms provide help. The website www.firma-ausland.de for example offers an information package on the legal prerequisites. This costs 149 euros. A more comprehensive package, containing information on important addresses, how to register with the police etc., costs 990 euros.

■ 3 Financing

The ifo economic institute has carried out a comparison of the varying levels of business insolvency in different countries. One aspect studied was the influence of national legislation. In this connection it is important to bear in mind that insolvency laws influence far more than just regulated exit from the market. They also affect important aspects of business conduct, such as the choice of legal form or the financing of projects through equity or third-party capital.

One can say that insolvency laws fall into one of two rough categories: predominantly debtor-friendly or

***Insolvency law and
insolvency totals***

predominantly creditor-friendly. Debtor-friendly laws lead to a higher number of insolvencies because they establish ownership rights which are advantageous to the debtor. In a country with debtor-friendly legislation, a business company, generally speaking, has less incentive to try to avoid insolvency, while an insolvent company can frequently use the rules to its own benefit, for instance when it comes to reaching an out-of-court settlement with creditors.

The "procédure de redressement judiciaire" in France is considered a very debtor-friendly procedure and this can help to explain the high volume of business failures in France. At the other end of the scale is Great Britain, with "administrative receivership", which is seen as friendly to creditors – and in Britain, there are fewer business failures than in most other EU countries.

However, the ifo study also confirms that there is not necessarily any direct link between the debtor- or creditor-friendliness of national legislations and default or late payment rates. After all, creditors can of course adapt their lending conduct to the specific legal framework. In France, for instance, a company's accounts receivable are particularly important, because all other assets are at the disposal of the insolvency court, which can sell them off, at a price it determines, with the aim of safeguarding jobs. So French banks have adapted their lending policies to the debtor-friendly environment and demand more in the way of collateral than, say, Germany or Britain and also choose other kinds of securities.

Bank loans still represent the main source of financing for business companies in Germany and the rest of Western Europe. However, alternative financing instruments, such as leasing and factoring, are becoming increasingly important. This is due mainly to the fact that, since banks are now generally applying rating procedures to their customers, a company's equity position plays a growing role in its ability to obtain bank loans on favourable terms.

***Insolvency legislation:
debtor– or creditor–friendly***

Leasing and factoring are considered to have the potential to become the most important alternative financing instruments alongside internal financing and bank loans. Leasing is a form of financing for capital goods in which the required investment object is purchased by a leasing company and then placed at the disposal of the user in return for the payment of a regular sum of money. Leasing is based on the principle that what matters is the use of, say, a machine, rather than its ownership. One important consideration in this connection is that in the event of an insolvency, the leasing company can get the goods in question back since they do not form part of the affected assets. In Germany, new leasing business has been increasing at an average of 5 percent a year. On a European comparison, Germany – with new leasing business of 51 billion euros and a market share of 19 percent in 2005 – is only just behind Great Britain (56 billion euros and 21 percent market share). Then come Italy (43 billion euros) and France (29 billion euros).

Creating liquidity

Companies making use of factoring as a financing instrument place their invoices for goods or services at the disposal of the factoring company, which pays the total sum involved after deducting a discount. This means that the firm concerned receives 80 to 90 percent of the nominal amount right away. This boosts liquidity and increases the level of equity. On an international comparison, according to a study by the KfW bank – the factoring market in Germany is still relatively small. But in the past 15 years it has been developing rapidly. In 2005 the relevant turnover volume was 55.1 billion, equivalent to a world market share of over 5 percent and putting Germany in 6th place. This factoring volume represents about 2.5 percent of GDP, compared with a European average of 8.5 percent. In Britain, the figure is over 13 percent. This lower volume is not the only thing which distinguishes Germany from the other developed European markets. There is also the fact that only about 3,200 companies use factoring as an instrument. That is less than 0.1 percent of all companies. In the other major European economies (France, Great Britain and Italy) the figure is between 3 and 5 percent

of all companies. There are also differences regarding the size of the companies concerned. Whereas in Germany, the average factoring turnover per customer is 17 million euros (2005), the figure in Britain, Italy and France is much lower, at around 1.7 million euros. (status: 2002).

Payment defaults

Table 6: Payment conduct in Europe in

■	Payment terms	Payment delay	Total
Italy	67 (67)	23 (22)	90 (89)
France	43 (47)	12 (11)	55 (58)
Great Britain	34 (33)	18 (21)	52 (54)
Belgium	34 (35)	13 (15)	47 (50)
Switzerland	24 (25)	16 (18)	40 (43)
Austria	29 (29)	10 (12)	39 (41)
Netherlands	25 (25)	14 (15)	39 (40)
Germany	25(26)	14 (14)	39 (40)
Sweden	28 (28)	9 (9)	37 (37)

() = 2005

One further factor which helps to explain national differences in the volume of corporate insolvencies is payment conduct. The longer a company has to wait for its bills to be paid, the greater the risk of illiquidity, unless it has sufficient reserves to bridge the gap.

It is an established tradition that companies in Italy have to wait longest for their money. In 2006, the average period before invoices were settled in Italy was exactly three months. The year before it had been 89 days and in 2004 87 days.

The Swedes, in contrast, demonstrate exemplary discipline. Companies there pay their bills within 37 days (prior year: 37).

In Germany, payment conduct is gradually improving. Invoices are now settled after 39 days on average; the year before the figure was 40 and in 2004 it was 42.

■ 4 Insolvencies and the economy

"In 2006, after years of disappointing results, the economy of the Economic Union will enjoy an upturn unprecedented in the past ten years. In 2007 and 2008 it will grow in line with potential. This is a clear indication of the benefits of economic reforms and budgetary consolidation against the background of a strong global economy. This should encourage the member states to pursue this path, because only in this way can broadly based economic growth be achieved and, with it, new jobs created", said Joaquin Alumina, European Commissioner for Economic and Monetary Affairs. In 2006, the number of people in gainful employment increased sharply, something due in part to the favourable structural reforms but also to renewed confidence in the economy. After peaking both in the EU as a whole and in the eurozone at 9 percent in 2004, the unemployment ratio fell in 2006 to around 8 percent. In parallel, due in part to the decline in the insolvency volume, the number of bankruptcy-related job losses fell for the third year in succession, to 1.4 million (prior year: 1.5 million).

Parallels between unemployment and insolvency

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
2006	1.4

The incidence of insolvency depends not only on general economic circumstances but also on the average size of companies, on the distribution of company sizes, on the legal forms available to business firms and on specific business sector developments.

Sectoral contributions similar

The business sector structure of insolvency in the eight companies surveyed here is remarkably similar. In all the countries, manufacturing posted the lowest relative rate of insolvency, and cut its contribution to the total volume by 1.4 percentage points, to 9.1 percent across the countries concerned.

Table 8: Contributions to the insolvency volume by the key economic sectors in Europe in 2006 (average)

■	Contribution to insolvency
Manufacturing	9.1 (10.5)
Construction	22.2 (20.2)
Commerce	33.4 (33.2)
Services	35.3 (36.1)

In percent, () = 2005

As in previous years, service firms accounted for the highest proportion of total insolvencies. But the relevant figure fell by 0.8 percentage points to 35.3 percent. It should be pointed out that, unlike in the German analysis, hotels, restaurants and cafés are included under the heading commerce, for the simple reason that this is how most European countries classify this segment. The construction industry, which in other countries is booming, is not among the most severely affected branches of the economy but it did make a higher relative contribution to the insolvency total, with 22.2 percent (prior year: 20.2 percent). Over a third of all corporate failures (33.4 percent; prior year: 33.2 percent) are in commerce (wholesale and retail).

Table 9: Insolvencies in the key economic sectors in 2006

■	Manu- facturing	Construc- tion	Com- merce *	Services
Belgium	6.7 (8.1)	13.4 (14.7)	53.1 (53.9)	26.7 (23.3)
Denmark	5.8 (11.9)	12.9 (15.5)	45.6 (38.1)	35.7 (34.5)
Finland	13.5 (15.0)	21.8 (19.9)	28.5 (30.4)	36.2 (34.7)
France	9.1 (8.9)	24.0 (21.4)	33.4 (35.0)	33.5 (34.8)
Germany	11.0 (10.9)	19.3 (21.1)	30.1 (29.2)	39.6 (38.8)
Great Britain	7.6 (17.3)	27.6 (24.0)	29.6 (22.1)	35.2 (36.6)
Netherlands	6.9 (11.5)	10.8 (13.3)	27.0 (29.5)	55.3 (45.7)
Norway	6.1 (10.1)	21.7 (11.0)	39.5 (47.4)	32.7 (31.5)

*) including hotels, restaurants and cafés, figures in percent. () = 2005

Among the eight countries considered here, it was Finland which has the greatest proportion of insolvencies in the field of manufacturing, with 13.5 percent (prior year: 15.0 percent). In Denmark, this sector accounted for only 5.8 percent of the total (prior year: 11.9 percent).

Only few industrial insolvencies

In all the countries reviewed, the construction industry made the second-lowest contribution to the insolvency volume. In Great Britain, it accounted for 27.6 percent of business failures (prior year: 24.0 percent). In the Netherlands, on the other hand, only one in ten insolvencies is in this branch of the economy (10.8 percent; prior year: 13.3 percent).

In the field of commerce, the relative incidence of insolvency varies considerably between the different countries. In Belgium, for instance, more than one insolvency in every two is in this sector (53.1 percent; prior year: 53.9 percent). In the Netherlands, on the other hand, business failures among retail and wholesale companies accounted for under one third of the total (27.0 percent; prior year: 29.5 percent).

In Germany, Finland, France, Great Britain and the Netherlands, it was the services sector which made the biggest contribution to the insolvency figures. This was most marked in the Netherlands, where the figure was 55.3 percent (prior year: 45.7 percent).

■ 5 National reports

5.1 Germany

Although the total number of insolvencies in Germany reached a new peak in 2006 (153,100 cases compared with 136,570 in 2005), the number of corporate insolvencies fell significantly, by 15.1 percent to 31,300. This is due on the one hand to the surge in the economy, which in the meantime is increasingly fuelled by domestic demand, from which small companies also benefit. Another factor is the development of interest rates in combination with less strict lending conduct on the part of banks.

Private insolvencies, on the other hand, are soaring in the opposite direction. Consumer bankruptcies rose by 22.1 percent. This figure includes formerly self-employed individuals, over-indebted estates, foundations and associations. The total was an unprecedented 121,800 cases.

Far fewer corporate insolvencies – sharp rise in private bankruptcies

Table 10: Insolvencies in Germany

■	2006	2005	Change in %
Total	153,100	136,570	+ 12.1
Companies	31,300	36,850	- 15.1
Private individuals	121,800	99,720	+ 2.,1

Corporate insolvencies are falling more sharply in Eastern Germany than in the West of the country. In the so-called "new" federal states of Eastern Germany, the number of business failures declined by 17.3 percent to 7,300 affected firms, the fall in Western Germany was 14.3 percent to 24,000.

The damage caused to the economy by insolvent companies in 2006 was 31.1 billion euros. That is below the prior-year level of 37.5 billion euros. There was also a decline in the number of employees affected by their company going broke: insolvency-related job losses fell by 16.0 percent to 473,000, as against 563,000 the year before.

5.2 Great Britain

In Great Britain, the number of corporate insolvencies rose only moderately last year, by 2.3 percent. But the volume of private insolvencies reached a new record level, increasing by all of 47.2 percent to affected 116,929 individuals.

Table 11: Insolvencies in Great Britain

■	2006	2005	Change in %
Total	130,706	92,888	+ 40.7
Companies	13,777	13,462	+ 2.3
Private individuals	116,929	79,426	+ 47.2

After 15 years of a property boom and economic upturn, British households have amassed total wealth of 1.3 trillion pounds. This development has been driven by the seductive combination of low interest rates and rising property prices. Close to 70 percent of Britons now live in their own four walls, financing this by means of mortgages with average durations of only three to five years and variable interest rates. So every time the Bank of England lowered the base rate in the past 15 years, the burden of payment for home owners fell the moment they were able to negotiate a new mortgage. At the same time, the value of their property rose. So millions of home-owners were able to sit back and get richer. But instead of paying off their mortgages or other loans, they invested their new-found wealth in conspicuous consumption. In the meantime, says analyst Matthew Czepliwicz of HSBC, "the party is gradually coming to an end". At the beginning of August 2006, the Bank of England lifted its key interest rate to 4.75 percent (it is now 5.25 percent). In combination with the high world market prices for oil and gas, this development increases the burden on British households – and this can ultimately lead to bankruptcy for increasing numbers of consumers.

Looming threat of property market collapse

British banks lay the blame for the record number of consumer insolvencies on the Enterprises Act of 2004. But they themselves are not entirely innocent. It is true

The end of the party?

that the good conduct period for bankrupts in England was reduced to just one year to enable small businesses in particular to made a fresh start, but on the other hand it was the liberal lending policy of the banks in the period up to 2003 which generated the credit boom. "At that time there were internal memos urging all staff to push our credit products", recalls a Barclays Bank branch manager.

5.3 Italy

Although the number of business insolvencies in Italy fell by 7.3 percent in 2006 to 15,900 affected companies, there were negative headlines when two state-owned transport companies became more or less bankrupt and highlighted the economic mismanagement of the five-year middle-right government under Silvio Berlusconi. The two companies were the Alitalia airline and the Italian railway network Ferrovie dello Stato (FS). Although Alitalia lifted the number of passengers in the first half of 2006 by over three percent to 11.7 million, its operating loss rose to 131.8 million euros (prior year: 83.8 million). This precarious situation had made the Italian government, which holds almost 60 percent of Alitalia, step in again and again with financial aid. All the same, in the middle of November 2006, Mauro Moretti, head of Trenitalia, the train service subsidiary of FS stated: "We are facing collapse." In Italy, this disaster surprised nobody; after all, FS is losing 6 million euros a day. At the end of the year. Trenitalia losses totalled 1.8 billion euros. Just how the rail system is to be rescued is currently the focus of heated debate. Rome is having to pursue an austerity programme and anyway Brussels will want a say in things to ensure that EU competition rules are not violated by any injection of vital capital.

Table 12: Corporate insolvencies in Italy

■	2006	2005	Change in %
	15,900	17,150	- 7.3

***Only limited access to
insolvency proceedings***

On June 17, 2006, a reform of the insolvency laws came into force in Italy, doing away in particular with antiquated notions such as denying bankrupts active and passive suffrage and the right to hold public office. However, experts believe that the reform was only a limited success. It failed, for instance, to take the step of combining the different judicial procedures. Italian law still recognizes only the insolvency of entrepreneurs, specifically only trading entrepreneurs. The right to file for bankruptcy is still withheld from public bodies or small firms, including craftsmen and farmers. The policy-makers also neglected to introduce consumer insolvency proceedings, so in the case of natural persons the only measure available is individual enforcement by writ.

NB: Creditreform Italy no longer obtains its data from the Ministry of Justice but from the commercial register, whose statistics also include the bankruptcies of natural persons who are company owners.

5.4 Spain

In Spain, the insolvency volume fell by 2.3 percent in 2006 to 849 affected companies. The number of bankruptcies in Spain is traditionally low and cannot really be compared with the figures posted by other countries. The reform of insolvency legislation carried out in 2003 has not changed that situation. A Spanish limited partnership, "Sociedad de responsabilidad Limitada", .S.L. for short, can be set up with subscribed capital of just 3,006 euros. As a general rule, when such companies fail they are not dissolved by means of an insolvency procedure – the owners simply leave their business premises, have their phones disconnected and move on to new ventures.

Nevertheless, the decline in insolvency figures does reflect this country's good economic climate. The Spanish economy is continuing to grow at a rate well above the EU average; the figure last year was 3.4 percent. The main growth drivers are private consumption and the construction sector, fuelled by rising wages, low interest rates in real terms, and

massive public investment in the country's infrastructure. The contribution made to GDP by foreign trade is negative – Spain imports far more than it exports.

Table 13: Corporate insolvencies in Spain

■	2006	2005	Change in %
	849	869	- 2.3

The options available under Spanish law in the event of a bankruptcy are a settlement between the debtor and his unsecured creditors, under which a maximum of 50 percent of the accumulated debts are waived or payment is deferred for at the most five years, or else a liquidation.

5.5 France

Unlike in previous years, France also registered a fall in its insolvency total, which declined to 38,369 cases, taking it back to the level of 2003. However, it seems doubtful whether this trend will continue this year, because after a good first half in 2006, economic growth in the third quarter was zero. In the view of almost all economists, the reason for this weakness is that French industry is finding it more and more difficult to compete in global markets. The only bright spot in the French economy is the readiness of the French to consume; in fact without this domestic demand France's economy would actually have shrunk in the third quarter. All the same: "The situation of the French economy remains precarious", believes Marc Touati of Bank Natexis. "It is definitely not capable of sustained growth of more than two percent a year." The reason for this is that France lacks the kind of innovative industrial Mittelstand to be found in Germany. Companies are either very small or very large, with nothing much inbetween. Among the main obstacles to growth are the high social welfare contributions which employers have to pay, the tax on wealth, the rigid labour legislation, excessive bureaucracy and the financing problems faced by small firms. Another factor is that companies with ten or more employees have to

permit the setting up of a works council. "For this reason, a very large number of firms just leave it at nine employees and do not seek further growth", says Patrick Artus, author of a government study on the competitiveness of French industry.

Insolvencies down as economy stagnates

Table 14: Corporate insolvencies in France

■	2006	2005	Change in %
	38,369	41,930	- 8.5

One insolvency that hit the headlines last year was that of the company that operates the Eurotunnel, which links France with Britain. At the beginning of August, the company applied for protection in line with the French variant of Chapter 11. Eurotunnel is in danger of collapsing under the burden of 9.1 billion euros in debts. For months, negotiations have been going on with the different groups of creditors with the aim of restructuring these debts. If the enormous debt load could be removed from its balance sheet, Eurotunnel would be a profitable company.

**■ 6 EU Eastward expansion:
New member states**

The new EU member countries in Central and Eastern Europe are systematically expanding their share of European trade. They now achieve annual growth rates in foreign trade in the double-digit range. The Vienna Institute for International Economic Comparison (WIIW) expects to see an increase in gross domestic product in real terms across all eight new EU states of 5.2 percent in 2006, following 4.7 percent in 2005.

According to the WIIW, the ongoing good economic climate is also finally leading to a slight easing of the labour market. Unemployment is expected to fall from an average of 13.5 percent in 2005 to 13.1 percent in 2006.

Table 15: Corporate insolvencies in Eastern Europe

■	2006	2005	2004	Change 2005/06 in percent
Czech Republic	4,100	3,882	3,643	+ 5.6
Estonia	461	450	436	+ 2.4
Hungary	9,447	7,983	7,804	+ 18.3
Latvia	730	746	1,217	- 2.1
Lithuania	808	773	708	+ 4.5
Poland	740	798	1,147	- 7.3
Slovakia	2,150	2,200	2,300	- 2.3
Slovenia	1,246	1,383	1,684	- 9.9
Total	19,682	18,215	18,939	+ 8.1

Unlike in Western Europe, the number of business insolvencies in Central and Eastern Europe has increased. Whereas in the prior year there were 18,215 affected companies, the figure in 2006 was 19,682, representing a rise of 8.1 percent. The biggest share of the insolvency volume, and also the biggest percentage rise, was posted by Hungary, with a total 9,447 insolvencies, equivalent to an increase of 18.3 percent. Business and financial circles are worried about Hungary's chronically high deficit in both the balance of current payments and the state budget. In contrast to the other new EU states, where budgets have improved, Hungary's 2006 budget will significantly fail to achieve the Maastricht criterion that limits new debt to three percent of GDP. Another factor is that by the end of the second quarter of 2006, the unemployment rate in Hungary had risen from 7.2 percent to 7.6 percent. The employment ratio is around 57 percent. In particular, the north-east of the country is a problem region, with a high level of unemployment and a weak infrastructure. On July 11, 2006, the Hungarian government agreed on a comprehensive package lifting taxes and other public charges. It can only be hoped that this austerity package will be sufficient to restore confidence in Hungary's financial policies.

Start-ups generate more insolvencies

Rising levels of insolvency were also reported by the Czech Republic, with an increase of 5.6 percent to

4,100 affected companies, and the two Baltic states of Lithuania (plus 4.5 percent to 808) and Estonia (plus 2.4 percent to 461).

The country with the biggest decline in the level of corporate insolvencies was Slovenia, where the total fell by 9.9 percent to 1,246. Slovenia's entire economic policy was geared to the introduction of the euro on January 1, 2007. This step meets with broad public acceptance because in an export-oriented like Slovenia the economic benefits of membership of the eurozone are manifest. The national bank and the finance ministry laid all the necessary groundwork at an early stage. In 2005, Slovenia reported economic growth of 3.9 percent, far above expectations. This was fuelled above all by the substantial increase in exports. In terms of purchasing power, per capita income (13,103 euros) is higher than in Portugal and Greece. Thanks to restrictive financial policies, the budgetary deficit is currently 1.29%. In the next few years, a slight rise in this figure is planned but all the same Slovenia meets the Maastricht convergence criteria both in this respect and also in respect of public indebtedness, which amounts to 29 percent of GDP.

Stable situation in Slovenia

Table 16: Insolvency ratios in individual Eastern European countries

■	Insolvencies per 10,000 companies
Poland	2
Czech Republic	51
Latvia	61
Hungary	73
Slovakia	77
Lithuania	127
Estonia	136
Slovenia	136
Total	32

Where its insolvency ratio is concerned, Poland is the "Spain of the East". Two insolvencies for every 10,000 active firms is a totally unbelievable figure and is simply an indication of the inadequate regulation of

Insolvency legislation still on its way

market exit. Slovenia and Estonia both report a ratio of 136, more or less equivalent to that in Switzerland (135). Latvia (61) has more or less the same insolvency ratio as Norway (60), while Hungary (73) and Slovakia (77) are just slightly above the level of Great Britain. The average insolvency ratio across all the new member states is 32 for every 10,000 companies, which is only just half that in Western Europe (65).

■ 7 Insolvencies in Japan and the USA

7.1 Japan

Just as in Germany and also in the USA, the insolvency volume in Japan fell in 2006. It recorded a year-on-year fall of 16.8 percent to 7,905 affected companies, equivalent to an insolvency ratio of 12 (number of insolvencies for every 10,000 companies).

In recent years, ongoing high-level deflation in the world's second-biggest economy had rendered monetary regulation by means of interest rates ineffective. Then, five months after the Bank of Japan (BOJ) had returned to the use of interest rates as a monetary instrument, the Mitsubishi UFJ Financial Group (which in terms of its balance-sheet total is the world's biggest banking group) lifted its prime rate for short-term loans to 1.6 percent. That rise, last August, was the first in six years.

Now, experts are increasingly worried about the possibility of the Japanese economy overheating, for instance as the result of excessively high corporate investment. According to the "Tankan" survey conducted by the BOJ, large companies were seeking to lift investment by 11.6 percent in the fiscal year up to the end of March 2006. Three months previously the plans had foreseen an increase of less than 3.0 percent. This means that Japanese companies are now investing more than they have for the past one and a half decades.

Interest rates generate rise in insolvency?

Table 17: Corporate insolvencies in Japan

■	2006	2005	Change in %
	7,905	9,498	-16.8

In June last year, i.e. before the interest rate hike, lending by Japanese banks increased at the highest rate for a decade. Small companies in particular are finding it easier to obtain bank loans. This means, says analyst Richard Jerram of the Australian investment bank Macquarie, that investment by small companies is also on an upward course. Developments on the insolvency front indicate that the availability of cheap money had helped to boost the stability of small firms. Whether the now higher interest rates have any negative impact on the number of insolvencies will only become apparent in the course of the coming year.

7.2 USA

The total number of insolvencies in the USA fell in comparison with the prior year by a sharp 71.5 percent. After the dismal negative record set in 2005 – when the USA registered more than two million private insolvencies for the first time – 2006 brought a very positive change, with the insolvency volume falling to 591,667, the lowest level since 1985. Business failures accounted for just 18,971 of this total, a fall of 51.6 percent. The remaining 572,696 cases involved private individuals aiming for a fresh start with the help of Chapters 7, 11 and 13. This figure also represented a marked decline, of 71.9 percent,. The insolvency ratio (number of insolvencies per 10,000 companies) in the USA in 2006 was 32 (if only business companies are taken into account) or 10 (including both companies and small traders).

Table 18: Insolvencies in the USA

■	2006	2005	Change in %
Total	591,667	2,078,415	- 71.5
Companies	18,971	39,201	- 51.6
Private individuals	572,696	2,039,214	- 71.9

The key reason for this rapid fall in the insolvency volume was the introduction of the Bankruptcy Abuse Prevention & Consumer Protection Act on October 17, 2005. This comprehensive reform of American insolvency legislation forces companies to make restructuring decisions at an earlier stage and also to service loans to a greater extent than before. Private individuals have to permit their financial circumstances to be subjected to closer scrutiny. The position of creditors, suppliers and landlords has been strengthened; investigation of the possibility of fraud is now more vigorous.

Law amendment stops rise in insolvency figures

Under the old laws, a debtor had virtually unlimited time to present a restructuring plan, and in some cases senior executives of an affected company were paid generous bonuses to stay with the company during restructuring efforts (pay-to-stay bonus). Lessees could take up to a year to decide what locations should be closed down, while suppliers who had delivered goods to an insolvent company just before the insolvency had only very limited possibilities for getting their money back.

Under the new law, a debtor must present a restructuring plan within 18 months. Otherwise it is up to the creditors to decide what is required. Tenants have to decide within 210 days whether they want to continue a lease contract or let it expire, while pay-to-stay bonuses for executives have been restricted – these can now be paid only if the person concerned can prove that he or she has other equally well-paid job offers. Suppliers who made deliveries in the 20 days before the insolvency have to be paid entirely or can otherwise reclaim their goods.

Even after the reform, though, the American insolvency legislation is a very generous model by international standards. Nonetheless, the announcement of the amendment led to a real flood of applications just before the final day, for instance from such prominent firms as Northwest Airlines and Delta. The number of consumer insolvencies rose by different rates in different regions, with figures of 10, 20 or even 50

"Insolvency bubble" prior to new law

percent. The applications for business insolvency rose by 11 percent in the final months before the legal changes. All this helps to explain why 2005 brought a negative record, while in 2006 there were marked declines on the insolvency front.

Just who is to blame for the enormously high incidence of consumer insolvency is a matter of debate among the experts. Credit card companies and banks are calling for even more restrictive laws to protect them against payment default, while others, such as lawyer Elizabeth Warren of Harvard University, put the blame firmly on the generous lending practices of the banks.

■ 8 Summary

The number of corporate insolvencies in the EU states plus Norway and Switzerland has fallen for the second year in succession. The insolvency volume declined by 8.5 percent to 141,448 affected companies (prior year: 154,510). Only three of the 17 countries surveyed reported a higher number of insolvencies. The biggest rise was in Finland, up 3.2 percent to 2,350. Portugal reported an increase of 3.0 percent to 3,400 insolvencies and Great Britain followed in third place with growth of 2.3 percent to 13,777 (prior year: 13,462).

The biggest decline in corporate insolvencies was in Denmark, where the total fell by 20.4 percent to just under 2,000 cases (prior year: 2,497). That corresponds roughly to the insolvency volume of the city of Cologne (1,800 cases in 2006). Next came Germany, which reported a drop of 15.1 percent. The number of companies which had to file for bankruptcy in Germany last year totalled 31,300, compared with 36,850 in 2005. Another country with a marked reduction in the number of insolvencies was Norway, where the figure fell by 12.0 percent to 1,913 (prior year: 2,175).

If the number of insolvencies is compared with the number of companies in a country, this gives the insolvency ratio. The highest ratios last year were

registered in Luxembourg (239 insolvencies for every 10,000 active firms), Austria (190) and France (149). In line with established tradition, the lowest insolvency rate was reported by Spain, with 3 business failures for every 10,000 firms, but that has less to do with a flourishing economy than with the inadequacy of the country's insolvency legislation for small and medium-size companies. The same basically also applies to the Mediterranean countries of Greece (7) and Italy (26) and to Portugal (27), all of which have an extremely low relative level of business bankruptcy. Over the EU-17 states as a whole, the average insolvency ratio fell last year from 77 to 65.

In contrast to the development of business insolvencies, the number of private bankruptcies in the countries surveyed – Germany, Great Britain, the Netherlands, Norway, Austria, Sweden and Switzerland – rose in 2006 by a substantial 30.7 percent to 256,841. This upward movement was headed by Great Britain, with a rise of 47.2 percent to 116,929 consumer insolvencies. In second place came Germany, with an increase of 22.1 percent to 121,800, followed by Austria, where the total climbed by 17.3 percent to 7,583. The only countries to buck this trend were Norway, with a sharp fall of 24.7 percent to 1,077 cases, Sweden, with a decline of 15.4 percent to 385 affected individuals, and the Netherlands, with a drop of 2.5 percent to 3,227.

Where the relative incidence of consumer insolvencies is concerned (the number of private bankruptcies compared with the size of the population), Germany – with 15 insolvencies for every 10,000 inhabitants – took second place, topped only by Great Britain with a private insolvency ratio of 20. The lowest relative incidence of private insolvencies was registered in Sweden (0.4), the Netherlands (2) and Norway (2).

Payment conduct in most of the countries surveyed has improved slightly. It is still Italian companies which have to wait longest for their money, with an average period of 90 days (prior year: 89). The fastest payers are Sweden, where invoices are generally settled

within 37 days (prior year: 37). In line with the lower volume of business bankruptcies, the number of insolvency-related job losses declined. Whereas in 2005, 1.5 million people lost their jobs following the insolvency of their employer, the figure in 2006 was 1.4 million.

The biggest contribution to overall business insolvency in 2006 was made by service firms, with 35.3 percent of the total volume (prior year: 36.1 percent). In next place came commerce (retail and wholesale), with 33.4 percent (prior year: 33.2 percent). Just over one in five insolvencies was in the construction sector (22.2 percent; prior year: 20.2 percent) and under one in ten was in manufacturing (9.1 percent; prior year: 10.5 percent).

In Eastern Europe, the number of corporate insolvencies increased by 8.1 percent last year, to 19,682 affected companies (prior year: 18,215). The most marked growth was in Hungary, with a rise of 18.3 percent to 9,447 (prior year: 7,983). The biggest decline was reported by Slovenia, where the number fell by 9.9 percent to 1,246 (prior year: 1,383). On the insolvency front, Poland could be described as "the Spain of the East": its insolvency ratio of just 2 bankruptcies for every 10,000 active firms is an absolutely unbelievable figure which indicates that insolvency legislation there does not function properly. The biggest relative incidence of insolvency was reported by Slovenia and Estonia, each with 136 insolvencies for every 10,000 companies.

In Japan, the number of corporate insolvencies fell in 2006 from 9,498 to 7,905. The USA reported marked falls in both business and private insolvencies, something due to the introduction of tougher bankruptcy regulations on October 17, 2005. Prior to that, there had been a real storm on the bankruptcy courts. In 2006, 18,971 companies applied for bankruptcy, corresponding to a decline of 51.6 percent (prior year: 39,201). The number of private individuals applying for release from their residual debts in 2006 was 572,696. In 2005, the figure had been 2,039,214, so the fall of 71.9 percent was truly enormous.

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