23 MARCH 2021

COFACE ECONOMIC PUBLICATIONS

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Insolvencies in France: more than 22,000 businesses in suspended animation

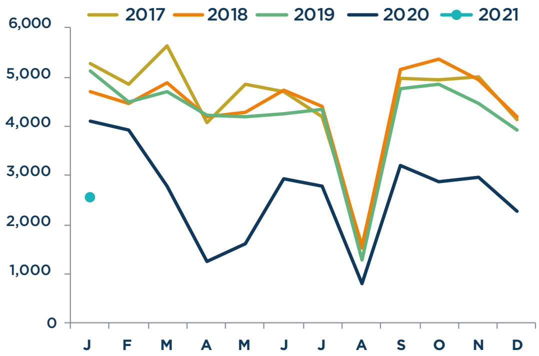
January 2021 continued the trend seen in 2020 in terms of business insolvencies as the number of insolvencies fell by 38% year-on-year – exactly the same decline as in 2020. While the economic crisis resulting from the health restrictions has not affected all sectors in equal measure, the number of insolvencies has dropped significantly across the board, including in sectors that have been out of business for several months (bars, clubs, restaurants, hotels, gyms). Even the smallest businesses, which are usually more vulnerable during recessions, saw a decrease in the number of insolvencies. There was one exception however: the number of insolvencies in businesses with a turnover of more than € 100 million per year rose from 8 in 2019 to 21 in 2020, with the four largest being in the clothing sector. As such, the average turnover of insolvent businesses has increased by 52%, and the financial cost of insolvencies – measured by total outstanding trade payables – is up 3% compared to 2019. On the other hand, the impact on employment remained limited, with 126,000 jobs affected by insolvencies over the year – the lowest level since 2006.

The atypical nature of this crisis and the unprecedented scale of the government's relief measures have, at least temporarily, broken the link between economic activity and business insolvencies. As a result, Coface has included the main business support measures (furlough scheme, state-backed loans, Solidarity Fund) in its insolvency forecasting model. Taking these measures into account, along with the drop in turnover by sector, the number of business insolvencies should have risen by 6.5% in 2020 in France. According to Coface's forecasting model, there should have been nearly 54,000 insolvencies in France in 2020, yet last year only 31,490 insolvency procedures were actually initiated. While it is difficult to precisely predict when these 22,500 "hidden" insolvencies will occur, they are expected to materialise between now and 2022, as normal activity gradually returns and support measures come to an end. According to Coface's forecasting model, there are an estimated 8,600 "hidden" insolvencies in France in the construction sector, 3,000 in the hospitality industry, 1,800 in retail, 1,500 in manufacturing, 1,200 in business services and nearly 800 in transport.

Insolvencies were down in all sectors...

The number of business insolvencies fell by 38% in January in France, keeping the same trend as in 2020, which saw 31,490 insolvencies compared to over 50,000 in 2019. Since June 2020, the number of monthly business insolvencies has been consistently falling – down 30 to 40% compared to the previous year **(Chart 1)**. Although this somewhat counter-intuitive trend (given the unprecedented collapse in business activity) initially appeared to be due to the moratorium on the requirement to file for insolvency within 45 days of illiquidity[1], the trend remained unchanged after the amendment expired on 24 August.

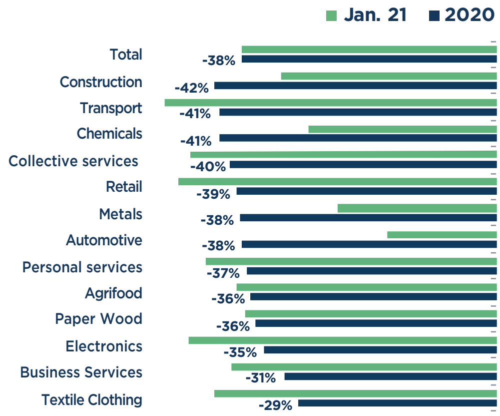
CHART 1
Monthly business insolvencies



Sources: Ellisphère, Coface

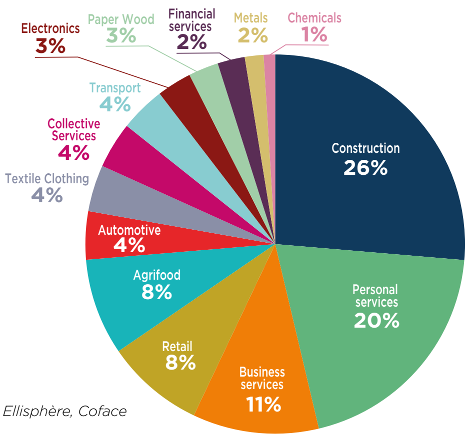
The trend is all the more remarkable in that it involves all sectors, with no exceptions **(Chart 2)**. This is despite the fact that sectors were impacted by the crisis in different ways, particularly in the second half of the year, when construction and industry were barely affected by the restrictions, unlike "non-essential" shops and services such as hotels and restaurants. There was therefore no correlation between the number of business failures and trends of activity. Given that all sectors saw a similar decrease in the number of insolvencies, their distribution by sector remained relatively unchanged in 2020 compared to previous years, with construction and personal services accounting for almost half of all insolvencies **(Chart 3)**. If we analyse the data by sector in greater depth, focusing on the activities directly affected by the health restrictions, the findings are identical: the number of insolvencies in bars, clubs, restaurants, hotels, gyms and shops fell from 26% to 39% in 2020 **(Table 1)**. Insolvencies continued to decrease in all sectors in January 2021 compared to the same month last year.

CHART 2
Annual change in the number of insolvencies by sector



Sources: Ellisphère, Coface

CHART 3
Breakdown of insolvencies by sector in 2020



Sources: Ellisphère, Coface

...but their financial cost has increased

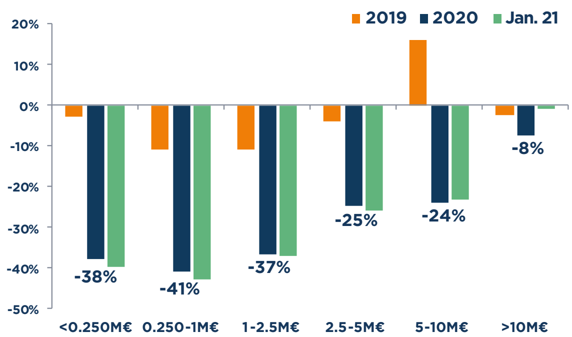
While business insolvencies have been extraordinarily homogeneous on a sector-by-sector basis, it is a more nuanced picture in terms of company size. Smaller businesses are typically more financially fragile and therefore vulnerable to economic crises, yet so far they have been less affected by insolvencies than larger companies. The number of insolvencies in businesses with less than € 2.5 million in turnover fell by around 40% in 2020 **(Chart 4)**. At the same time, those with a higher turnover have seen a smaller reduction in insolvencies.

TABLE 1
Annual change in the number of insolvencies by sector

		Hotels	Restaurants	Bars & clubs	Gym	Shops	*(including non-food retail)*
NUMBER OF INSOLVENCIES	2019	301	5,206	1,164	163	6,017	*4,066*
	2020	212	3,165	706	120	3,746	*2,572*
	Jan. 21	19	206	39	13	264	*166*
ANNUAL CHANGE	2020	-30%	-39%	-39%	-26%	-38%	*-37%*
	Jan. 21	-27%	-48%	-58%	-7%	-47%	*-48%*

Sources: Ellisphère, Coface

CHART 4
Annual change in insolvencies by turnover bracket

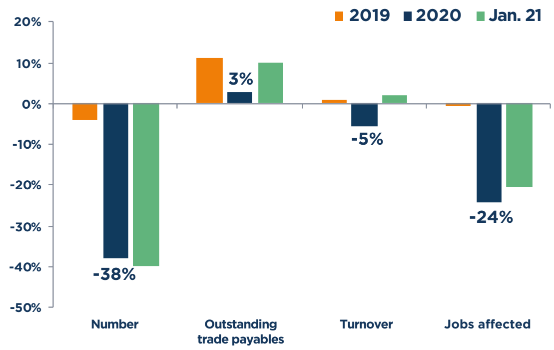


Sources: Ellisphère, Coface

1 - . De Moura Fernandes "*Corporate insolvencies in Europe: temporary framework amendments kick the can down the road*", Focus Coface, June 2020

The number of insolvencies of businesses with a turnover of more than € 100 million per year actually rose from 8 in 2019 to 21 in 2020. The majority of these businesses were already in a fragile financial condition, which then further deteriorated under the effect of the pandemic. The four main insolvencies in 2020 affected ready-to-wear brands: LA HALLE (turnover of € 859m), CAMAIEU (€ 705m), CELIO (€ 468m) and KIDILIZ (€ 435m including the group's central purchasing unit). Another sector that was in great difficulty long before the crisis was furniture retail, which last May saw the failure of the ALINEA chain (€ 257m).
This trend continued in January, with the number of insolvencies of companies with under € 10 million in turnover being down 38%, while at the same time the number of insolvencies of businesses with higher turnovers was up: 22 compared to 12 in January 2020. One insolvency of a company with over € 100 million in turnover was recorded in early 2021, when the FLUNCH restaurant chain (€ 512m) was placed under a safeguard procedure.
In turn, although the number of insolvencies decreased in 2020, the average turnover of insolvent businesses rose to € 460,000 (up 52% compared to 2019). The financial cost of insolvency also increased in 2020: total outstanding trade payables reached € 3.75 billion, up by 3% over the previous year **(Chart 5)**. Unsurprisingly, the start of 2021 confirmed these trends, as the average turnover of insolvent businesses in January was € 550,000. In contrast, "only" 126,000 jobs were affected by insolvency proceedings in 2020 – the lowest level since 2006. The number of jobs impacted has fallen in all sectors, except for clothing, owing to the insolvencies of the above-mentioned major retailers. The decrease in insolvencies was seen in all regions in 2020. All regions recorded a clear drop in the number of insolvencies, ranging from 34% in Brittany to 49% in Corsica.

CHART 5
Annual change in the cost of insolvencies

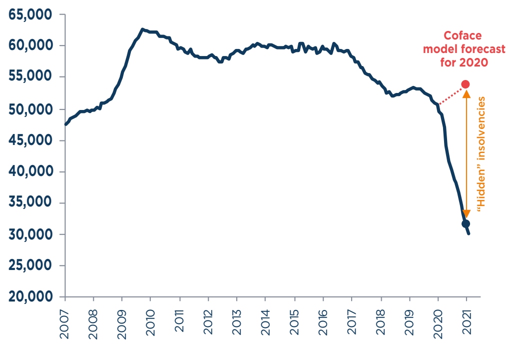


Sources: Ellisphère, Coface

A deceiving decline: more than 22,000 "hidden" insolvencies expected to materialise by 2022

As explained in our previous publication[2], the atypical nature of this crisis and the unprecedented scale of government support measures have temporarily made the relationship between economic activity and business insolvencies obsolete. We have therefore decided to integrate the main support measures into our insolvency trend forecasting, which is conducted in two stages. First, we used the European business accounts available in the Banque de France's BACH database, focusing on six sectors (construction, retail, manufacturing, hospitality, business services and transport), which account for three quarters of insolvencies in France. We then applied four shocks to the 2019 financial accounts of each sector, so as to simulate their trends in 2020. First, we applied the 2020 change in activity to turnover. We then reduced the wage costs of each sector using the furlough scheme data, and recorded the amounts obtained from the Solidarity Fund as subsidies. These first three shocks resulted in a simulated gross operating profit (GOP) for 2020. On the other hand, the state-guaranteed loans (PGE) received by each sector are increasing companies' cash flow without being recorded as short-term debt, as the vast majority of companies will only begin to repay the loans in 2022[3], i.e. beyond our forecast horizon. This therefore gives us the simulated net debt for 2020. As such, based on the ratio between GOP and net debt, we obtain a simulated solvency ratio for 2020. Lastly we use this solvency ratio as an explanatory variable in our insolvency forecast model.
Taking into account the drop in turnover by sector, while integrating these support measures into the sector-by-sector accounts, the number of business insolvencies should have risen by 6.5% in 2020 **(Chart 6)** – a very slight increase given the scale of the economic recession.

CHART 6
Number of business insolvencies over 12 months



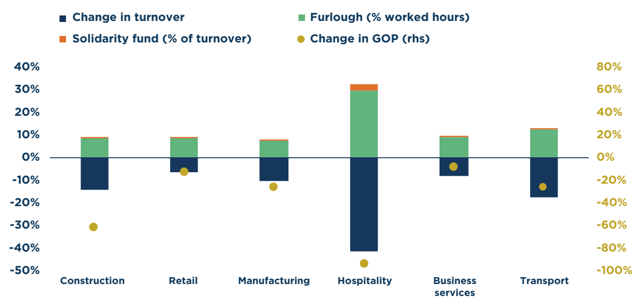
Sources: Ellisphère, prévision Coface

According to our forecast model, nearly 54,000 insolvencies should have been recorded in France in 2020. This is around 22,500 more than the number actually initiated last year. While the precise timing of these insolvencies is difficult to predict, these "hidden" insolvencies are expected to materialise when business returns to normal (increasing cash needs to finance production and fulfil order books) and when the support measures expire. While "normal" business should return to most sectors in the second half of the year, depending on the timing of vaccination campaigns, business support measures could be gradually phased out beyond 2021. For example, the long-term partial activity scheme could be applied until 30 June 2022, and the repayment of state-backed loans could be spread out until 2026 or even 2028 if talks with the European Commission prove successful. As such, we expect these more than 22,000 "hidden" insolvencies to gradually materialise in 2021 and 2022.
According to Coface's forecast model, this expected increase in insolvencies is likely to affect the economy's main sectors in different ways **(Chart 9 - *See next page*)**. The hospitality sector, undeniably the most affected by the fall in turnover, only comes third among the sectors most at risk in terms of insolvency due to the much greater use of furlough scheme and the Solidarity Fund, which accounted for almost 3% of the sector's turnover in 2020, i.e. five times more than transport and ten times more than construction **(Chart 7 - *See next page*)**.
In total, the model has counted 3,000 "hidden" insolvencies in the sector. However, despite the rebound in activity in the second half of 2020 and notable resilience during the second wave, the construction sector was the most impacted last year. Because of the closure of

2 - M. Carias, B. De Moura Fernandes & C. von Berg "*The business insolvency paradox in Europe: miracle and mirage*", Focus Coface, March 2021
3 - According to the quarterly Barometer published at the end of February 2021 by Bpifrance Le Lab and Rexecode, only 32% of SMEs and VSEs that have benefited from a state-backed loan intend to repay it at least partially in 2021. Furthermore, 59% of the SMEs and VSEs that were granted a PGE planned to spread out their repayments up until 2026.

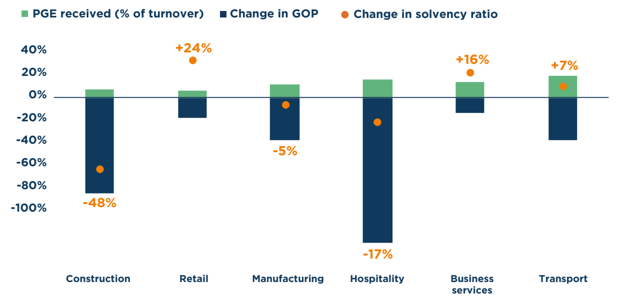
construction sites during the first lockdown (leading to a fall in turnover that was not recovered over the rest of the year) and because the sector made little use of all the support measures, business deteriorated sharply and 17,000 companies should have become insolvent in 2020, i.e. 8,600 more than the number actually recorded. Although this was slightly less negative thanks to the wider use of PGEs, a similar situation was found in the manufacturing sector, despite an upturn in most sectors at the end of the year driven by exports: only 2,000 insolvencies were recorded, compared to the 3,500 forecast. At the same time, as support measures more than compensated for the fall in turnover, the other key sectors saw their solvency ratio improve in 2020 **(Chart 8)** and so the Coface model forecast fewer insolvencies than in 2019.
However, as the decrease was much greater than expected, the number of "hidden" insolvencies is estimated at 1,800 in retail, 1,200 in business services and almost 800 in transport.
It is worth noting that in the absence of available data at a more disaggregated sectoral level, this number may be underestimated in some sectors – such as retail – which are made up of a large number of branches that saw heterogeneous trends in 2020. Therefore, based on the data available, the drop in turnover in the sector as a whole has been limited, and the use of furlough scheme is relatively high, which explains what initially seemed to be a surprisingly low forecast of insolvencies, falling by 9% in 2020.
Nevertheless, the positive performance of the food retail sector is likely to be masking the difficulties of some "non-essential" business that were forced to close twice last year, without this having a significant impact on the turnover of the retail sector as a whole.

CHART 7
Simulated Gross Operating Profit (GOP) in 2020



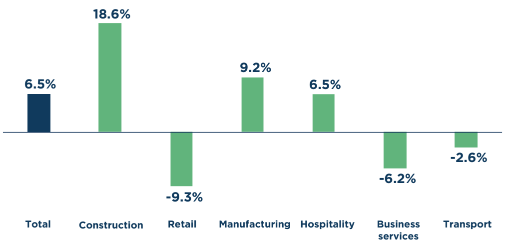
Sources: Coface estimate based on BACH (Banque de France) and government data

CHART 8
Simulated solvency ratio in 2020



Sources: Coface estimate based on BACH (Banque de France) and government data

CHART 9
"Expected" increase in insolvencies in 2020 by sector



Sources: Coface estimate based on Ellisphère, BACH (Banque de France) and government data

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