

Insolvencies in Europe

■ 2004/05

A survey by the
Creditreform
Economic Research Unit


Creditreform

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■ 1 Introduction

In 2004, the world economy boomed on a scale not seen for almost three decades. The only drop of bitterness was the strong increase in the price of oil. By taking spending power out of the economy, this slowed down private consumption. Supported by expansive monetary policy, business investment became increasingly dynamic.

But Germany's slice of the economic cake was on the thin side. Since 1995, Germany – alongside Portugal and Italy – has been one of the tail-enders where growth is concerned. On the other hand, the ten countries which joined the European Union in 2004 grew at an above-average rate. This is particularly true of the Baltic countries, where a robust economic performance is being accompanied by a sharp increase in industrial output. But the market economy structures in these countries are still young and not yet firmly grounded. This is apparent in any survey of the laws on market entry and exit in these countries. In most cases there is still no functioning insolvency legislation backed by the requisite judicial apparatus and only rarely are offences against any existing bankruptcy laws actually prosecuted. This is Creditreform's 15th survey of the insolvency situation in Europe and it is the second time that we have covered the new member states, which are analysed in a separate section.

■ 2 Insolvencies in Western Europe in 2004

2.1 Corporate insolvencies

The number of corporate insolvencies in the EU-17 states increased by 1.0 percent to 156,245 (prior year: 154,627).

So the trend that began back in 2002 towards a slower rate of increase in the number of business insolvencies is continuing. The figure then was still a high 10.7; in 2003, this fell to 2.2 percent, while last year's growth of just 1.0 percent represents another drop in the rate of growth.

Tab. 1: Corporate insolvencies in Europe (2002 – 2004)

■	2004	2003	2002	Change 2003/04 in percent
Austria	6,273	5,643	5,281	+ 11.2
Belgium	7,937	7,593	7,222	+ 4.5
Denmark	2,573	2,506	2,469	+ 2.7
Finland	2,463	2,769	2,885	- 11.1
France	40,042	38,296	37,987	+ 4.6
Germany	39,600	39,470	37,620	+ 0.3
Great Britain	12,827	14,815	17,094	- 13.4
Greece	577	480	489	+ 20.2
Ireland	321	346	379	- 7.2
Italy	17,457	16,202	15,500	+ 7.7
Luxembourg	671	655	695	+ 2.4
Netherlands	6,574	6,386	6,489	+ 2.9
Norway	2,675	3,084	2,603	- 13.3
Portugal	3,100	2,980	2,092	+ 4.0
Spain	570	646	629	- 11.8
Sweden	7,630	8,237	7,819	- 7.4
Switzerland	4,955	4,539	4,002	+ 9.2
Total	156,245	154,647	151,255	+ 1.0

However, the way the business insolvency situation has developed varies considerably from between countries. The biggest increase in the volume of insolvencies was in Greece, with a rise of 20.2 percent. In absolute terms this represented a rise from 480 firms to 577 in 2004. The European soccer champion also attracted attention last year because of improper conduct in regard to the EU stability pact: the country has allegedly "corrected" its budget deficit downwards by an average of two percentage points since 2000.

The second and third slots in the insolvency growth rates were occupied by Germany's neighbours Austria and Switzerland. With a total of 6,273 business collapses, Austria posted an all-time high. But according to the president of the Credit Protection Association, Hans-Georg Kantner, "The situation here has definitely peaked. From now on things can only get better..." In addition to the high rate of increase in business insol-

vencies (up 11.2 percent), a particularly disquieting fact was that the number of bankruptcy petitions dismissed for lack of assets increased by 24.0 percent last year. In fact nowadays more than half of all bankruptcy proceedings in Austria are not even opened.

In Switzerland the insolvency volume, with almost 5,000 affected companies, accords with the general impression of a weak economic climate. As the reason for their failure, 47 percent of the companies surveyed by Creditreform Switzerland cited their financing situation. However the insolvency growth rate of 9.4 percent is offset by a large number of start-ups: some 33,443 new firms were founded in 2004, 7.4 percent more than the year before and the highest number for seven years.

The most marked decline in insolvency volume was registered by the United Kingdom (minus 13.4 percent), Norway (minus 13.3 percent) and Spain (minus 11.8 percent). However, the data on Spain has only limited significance because in the case of a large number of insolvent firms no insolvency proceedings were pursued.

Great Britain does best

The clear-cut winner in the European insolvency contest is Great Britain (England, Scotland and Wales). Last year the number of business collapses fell by 1,988 (13.4 percent) to 12,827. Few big industrial countries have experienced such a successful economic development in the past few years as Britain. For the last twelve years, every quarter has brought an improvement, and according to the most recent EU statistics, the average income in Britain (measured in terms of purchasing power) now exceeds that in Germany by ten percent.

The Norwegian economy is fundamentally different from that of other European countries. Within just one generation, Norway accomplished the quantum leap from being one of the poorer European nations, with an economy based mainly on shipping and fisheries, to becoming the world's third-biggest oil exporter. In

2004, the interest rate policies followed by the Norwegian Central Bank – which between December 2002 and March last year had lowered the key interest rate in ten steps from 7.5 percent to 1.75 percent – bore fruit for the first time. This produced a fall in the high exchange rate of the Norwegian krone and thus helped to boost exports. That is the background to the decline in business insolvencies in Norway by 13.3 percent to 2,675 last year.

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

■	Insolvencies per 10,000 companies
Spain	2
Greece	8
Ireland	33
Italy	39
Portugal	45
Great Britain	57
Finland	111
Norway	112
Netherlands	115
Denmark	125
Germany	135
Switzerland	144
Sweden	157
France	160
Belgium	181
Austria	234
Luxembourg	280
Total	81

Insolvency ratios comparable only to a limited extent

A country's insolvency ratio is derived by setting the number of bankruptcies against the total number of firms in that country. The highest insolvency ratios were in Luxembourg (280 bankruptcies for every 10,000 companies), Austria and Belgium. The lowest was in Spain, although as already mentioned this has more to do with judicial/administrative factors than with business performance. The average insolvency ratio in Western European countries was 81, as against 79 in 2003. Germany, with a ratio of 135, is worse than ave-

rage but still only in the lower mid-range of the Western European countries.

2.2 Private indebtedness

Not all European countries have specially devised judicial procedures for private individuals who want to file for bankruptcy in order to obtain debt forgiveness. In France, for instance, the proceedings for over-indebted private individuals are not a judicial matter at all. Instead, every Département has special commissions aimed at bringing about an amicable settlement between creditors and debtors. If this is successful, all the individual's remaining debts are cancelled. The French Code de la Consommation does not have any good conduct period like that in Germany. However, in August 2003, France did institute a judicial procedure for "hopeless and longterm" over-indebted individuals. But there is no statistical data on this "rétablissement personnelle".

In a verdict passed in 2001, the German Federal High Court laid down that any exemption from residual debts granted in France also applied to outstanding obligations in Germany if the permanent domicile of the person concerned was in France. One result is that there is now an Internet firm which offers to make individuals in Germany "free of debt in 18 months" by handling all the formalities involved in the French procedure. This covers everything from finding a place in France for the person to live in France (quote: "You have to have a normal apartment – a one or two-room flat with bath and kitchen. The procedure doesn't apply if several people simply share a furnished room"), drawing up the rental agreement, registering the individual with the police, registering electricity, water and telephone. It also includes preparing all the necessary documents and initiating the insolvency proceedings. But just how an already over-indebted German is expected to raise the fee of almost 25,000 euros – in advance of course – the firm doesn't say!

Tab. 3: Private insolvencies in Europe

■	2004	2003	Change 2003/04 in percent
Austria	5,613	4,458	+ 25.9
Germany	76,100	60,880	+ 25.0
Great Britain	48,105	38,932	+ 23.6
Netherlands	2,611	2,362	+ 10.5
Norway	1,685	2,139	- 21.2
Sweden	406	387	+ 4.9
Switzerland	5,469	5,140	+ 6.4
Total	139,989	114,298	+ 22.5

In Germany, consumer insolvency proceedings were introduced in 1999 and amended in 2001. Since then, the number of bankruptcy applications by private individuals has grown steadily. In 1999 7,250 consumers and formerly self-employed persons went to court to seek debt-forgiveness, today the figure is ten times that (76,100; prior year: 60,880). But this kind of development is not confined to Germany, as a glance at the situation in other European states and the USA quickly reveals. Last year only Norway registered any decline in consumer insolvencies. There, the total fell from 2,139 in 2003 to 1,685, equivalent to a decrease of 21.2 percent.

All the other states posted increases, in some cases on a double-digit scale. Austria in particular has to face a growing number of consumer insolvencies. The figure there rose by 1,155 (25.9 percent) on 2003. In Austria, where the relevant proceedings were introduced in 1995, it is estimated that today there are some 400,000 people with serious liquidity problems, and in 2004 5,613 applied for private bankruptcy (2003: 4,458). In Great Britain, the length of the proceedings for liberation from residual debts was reduced in April 2004 to just one year, which certainly helps to explain the enormous increase in such cases – they were up by 23.6 percent.

In all, the number of consumer insolvencies in Western Europe rose by 22.5 percent to almost 140,000. But this figure is in fact only just the tip of the iceberg, as

can be seen by looking at the over-indebtedness situation in selected countries in the European Union. In Germany, for instance, up to nine percent of the population are considered over-indebted. In Great Britain the figure is seven percent. In Finland, on the other hand, it is just two percent.

Over-indebtedness is the term used to describe a situation in which a debtor is not able to meet his financial obligations either at present or in the foreseeable future. And this phenomenon is on the increase. Changes in societal structures (with the gradual disappearance of family-based help and support mechanisms), instability in household life-cycles (flexible earnings biographies with substantial fluctuations in income) and the need for greater financial responsibility following the retrenchment in public-sector security systems (health and old-age insurance) – the combination of all these factors makes it easier for people to slip from owing money to becoming over-indebted. Those affected have largely similar social-demographic characteristics in all the countries where this phenomenon occurs: they are mainly single parents and singles of between 25 and 45 who are unemployed or earn only low incomes.

Tab. 4: Proportion of over-indebted private households (estimate)

■	In percent
Belgium	1 – 4
Finland	2
France	3
Germany	9
Great Britain	7
Netherlands	4
Sweden	3

Sources: L’Observatoire du crédit et de l’endettement (Belgium), Statistics Finland and The National Research Institute of Legal Policy (Finland), Task Force on Overindebtedness (Great Britain), Swedish Consumer Agency (Sweden), estimates by the French government, Federal Ministry of Justice (Germany)

If the number of business insolvencies and – where applicable – consumer bankruptcies in the Western

European (EU-17) countries are added together, the total last year was almost 300,000 (296,234). The year before the figure was 268,945, 10.1 percent lower.

■ 3 Insolvencies in Germany

The good news first: In 2004, Germany achieved its biggest balance of trade surplus since the Second World War. This was driven by strong growth in exports, which rose around 10 percent to 731 billion euros. If trade in services is excluded, Germany still lies ahead of the USA and has thus successfully defended its title of "Export World Champion".

Now the bad news: "Once we were the locomotive, now we're the tail-ender", is how Hans-Werner Sinn, head of the ifo economic research institute, sums up the German economic situation in 2004. The country's economic growth, at 1.7 percent, was one of the lowest in Europe. The unemployment ratio, at 9.3 percent, was higher than at any time since 1997, and private consumption shrank by 0.3 percent.

With a total of just under 40,000 business collapses, Germany takes second place in the European bankruptcy charts. And even though last year's increase was only 0.3 percent, there is still no indication of the hoped-for turnaround.

The rise in the insolvency volume is fuelled mainly by Western Germany, where 30,200 firms filed bankruptcy applications – 1.9 percent more than in 2003. In Eastern Germany, the number of corporate insolvencies has actually been falling since 2003: The figure for 2004 was 9,400, 4.3 percent lower than the year before.

Tab. 5: Insolvencies in Germany

■	2004	2003	Change in %
Total	115,700	100,350	+ 15.3
Companies	39,600	39,470	+ 0.3
Private individuals	76,100	60,880	+ 25.0

Changes in the law

The number of insolvencies by private individuals is almost twice as high as the business bankruptcy total. Last year, 76,100 consumers and formerly self-employed persons made their way to the bankruptcy courts, an increase of 25 percent on 2003. The rise was due on the one hand to changes in the law which make it easier for many over-indebted individuals to free themselves from their financial obligations on a lasting basis. On the other hand, the high unemployment rate and growing numbers of divorces and separations also cause over-indebtedness, often leading ultimately to a bankruptcy application.

The economic damage caused by insolvencies in 2004 totalled 39.4 billion euros. The impact on the public sector was 11.9 billion euros; on private creditors it was 27.5 billion euros. The number of employees affected by their employer going broke in 2004 came to 605,000. This is the first fall (minus 1.3 percent) since 2000. But whether this downward direction will be maintained in 2005 seems unlikely, since the year started with the failure of construction company Walter Bau, which hit 4,500 direct employees and many others working for subcontractors.

■ 4 At the core of the problem: Financing

In the European economic region, including Switzerland, there are around 19.3 million business companies, which together employ around 140 million people. Only 0.2 percent of all companies have a workforce of over 250, the others are small and medium-sized enterprises (SMEs). What most SMEs have in common is the difficulty of obtaining financing. Usually, such firms depend mainly on bank loans, and although alternative sources of financing, such as leasing or factoring, are gaining in importance, they will not be able to displace bank loans as the chief source of outside capital.

When firms are unable to obtain the loans they need, this is often because they cannot offer securities and lack capital resources. Small and young firms in particular find it difficult to provide the sureties which banks demand. And for banks, granting a loan is risky

Equity and insolvency

if a firm does not have an adequate equity ratio and utilizable securities. But equity capital is important not only in obtaining loans, it also functions as a buffer to bridge liquidity bottlenecks or periods of economic weakness. Generally speaking an equity ratio of over 30 percent (in relation to the balance sheet total) is considered stable. But comparing average equity ratios in different countries is possible only to a certain extent. Spanish and British SMEs are relatively well-funded, whereas Germany, with an average ratio of 7.5 percent, is at the bottom of the table, in line with the country's high insolvency volume.

Tab. 6: Equity ratios of European SMEs

■	In percent
Spain	41.0
Great Britain	40.0
France	34.0
Italy	22.0
Germany	7.5

Source: BDI, Bundesbank, Creditreform

At a joint conference of the World Bank and the international Savings Bank Federation in November last year, the UEAMPE (European Association of Craft, Small and Medium-sized Enterprises) presented an extensive four-pronged program to promote the financing of SMEs in Europe. This proposed that when the Basel II Accord is implemented, every opportunity should be taken to keep the new rules as simple as possible. In addition provision must be made to enable all standard sureties to be used to obtain a loan. To compensate for the disappearance of state guarantees for banks and to offset their increased risk awareness, credit guarantee systems should be expanded; for this, more money should be made available to the European Investment Fund. Corporate and income tax systems should be amended to make it more attractive to re-invest business profits, thus enabling firms to build up capital. And finally SMEs should have easier access to risk capital to improve their chances of obtaining equity financing; there should be support for secondary markets for venture capital investments in

***Approaches for improving
SME financing***

SMEs, backed by a more transparent exchange of information with investors.

Tab. 7: Payment conduct in Europe in days

■	Payment terms	Payment delay	Total
Italy	66 (64)	21 (21)	87 (85)
France	47 (45)	12 (11)	59 (56)
Belgium	38 (40)	18 (23)	56 (63)
Great Britain	32 (30)	22 (25)	54 (55)
Austria	29 (27)	14 (12)	43 (39)
Sweden	27 (26)	8 (10)	35 (36)
Netherlands	26 (25)	16 (20)	42 (45)
Germany	26 (24)	16 (16)	42 (40)
Switzerland	26 (23)	17 (15)	43 (38)

() = 2003

For SMEs, supplier credits are one of the most important sources of short-term finance. One reason for this is that smaller companies often suffer from an acute lack of liquidity as a result of delayed payments by their customers. The length of time before an invoice is paid varies – often considerably – between individual European countries. The average figure for Italy is 87 days (prior year: 85 days), but French and Belgian companies also allow plenty of time before they settle their debts. In France the average waiting period is 59 days (2003: 56), in Belgium it is 56 days (prior year: 63). The country where bills are paid fastest is Sweden, where the average figure is 35 days (prior year: 36 days).

The British Federation of Small Businesses has carried out a survey of the payment conduct of over 300 British plcs which revealed that only one third of all plcs settle their invoices punctually within 30 days. The worst payer needed all of 548 days before it settled outstanding bills. This is despite the fact that the Late Payment of Commercial Debts (Interest) Act of 1998 and the Late Payment of Commercial Debts Regulations of 2002 were intended to ensure more punctual payment and thus improve the cash flow particularly of small companies. By law, a company of any size can now demand interest on late payment and compensa-

Huge individual differences

tion for at least part of the debt collection costs. The rate of interest was set at 8 percent above the Bank of England's base rate, while up to 100 pounds of the debt collection costs can be recovered.

But in Great Britain, just as experience in Germany has shown, practical problems actually thwart the point of the laws. According the Federation of Small Businesses small companies in particular shy off from exercising their rights and making their customers pay interest and the debt collection costs. In their reminder letters, only about 15 percent of small firms even mentioned their right to interest on late payments; with large companies 55 percent make this clear. So the existing legal opportunities are not used because of the fear of losing customers.

■ 5 Insolvencies and the economy

After a very good start in 2004, the world economy slowed down slightly in the second and third quarters. One major dampener were the high oil prices, which reached new peaks in the wake of increased demand. However, no global collapse in economic recovery is to be feared, because sharp international competition for sales markets and production locations reduced the risks of inflation. So the situation is different from that caused by the oil price shocks of the 70s and 80s. Experts assume that worldwide economic growth will continue in 2005, although perhaps at a slightly slower pace. In the Eurozone, economic growth in Q3 halved as a result of the decline in export impulses. This significant slowdown shows just how much the Eurozone depends on global economic developments. Internal growth forces have not developed sufficient dynamism to counteract any fall in exports. This is due above all to the labour market problems facing most European states, where the average unemployment rate in 2004 remained at 8.9 percent.

What's lacking is internal dynamism

Tab. 8: 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

Nevertheless, the number of people who lost their jobs because their employer had to apply for insolvency declined slightly. In 2003, the figure had been 1.7 million, in 2004 it was 1.6 million and thus back to the level of 2002.

The fall in the number of insolvency-related job losses despite the increase in the number of corporate insolvencies is due above all to the size of the firms going broke. This once again underlines the fact that insolvency is a problem chiefly affecting small and medium-sized enterprises. Mega-crashes, such as the recent collapse of Walter Bau with the loss of 4,500 jobs, naturally attract greater public interest than the bankruptcy of the baker next door. But it must not be forgotten that a company the size of Walter Bau also takes many small subcontractors with it into insolvency.

SMEs as a workforce reservoir

Tab. 9: Contribution to the insolvency volume by the key economic sectors in Europe 2004 (average)

■	Contribution to insolvency
Manufacturing	10.2 (11.2)
Construction	18.6 (20.6)
Commerce	26.5 (25.3)
Services	44.7 (42.9)

In percent, () = 2003

In the countries surveyed, it is traditionally the service sector which fuels the insolvency volume most strongly. Last year, the relative contribution this sector made to the total volume of insolvencies increased once again to almost half of the total (44.7%; 2003:

42.9 percent). On the other hand, as a result of the good economic climate in the field of manufacturing at least in the first three quarters of 2004, this sector's share shrank, from 11.2 percent to 10.2 percent. And it is gratifying the note that the construction sector also registered a relative decline in insolvencies: whereas in 2003, one bankruptcy in every five was in the construction industry (20.6 %), the figure in 2004 was 18.6 percent.

Tab. 10: Insolvencies in the key economic sectors 2004

■	Manu- facturing	Construc- tion	Com- merce *	Services
Belgium	7.9 (8.3)	13.9 (1.9)	33.7 (32.3)	44.6 (45,4)
Denmark	8.6 (10.7)	11.1 (1.6)	42.6 (42.5)	37.7 (34,2)
France	10.7 (11.3)	23.8 (2.3)	25.2 (26.4)	40.3 (39,0)
Germany	8.3 (9.1)	20.2 (2.7)	23.8 (23.7)	47.7 (46,4)
Great Britain	18.5 (18.7)	17.2 (2.9)	22.7 (19.1)	41.7 (40,3)
Netherlands	12.1 (13.9)	13.4 (1.5)	32.1 (22.4)	42.4 (48,2)
Norway	10.0 (10.9)	10.9 (1.9)	34.3 (32.1)	44.8 (46,0)

*) including catering, figures in percent, () = 2003

Services biggest insolvency driver almost everywhere

The distribution of insolvency among the main branches of the economy varies, often quite considerably, from one country to another. The proportion contributed by manufacturing was, for instance, highest in Great Britain (18.5 percent; prior year: 18.7 percent) and only low in Belgium (7.9 percent; prior year: 8.3 percent), Denmark (8.6 percent; 2003: 10.7 percent) and Germany (8.3 percent; 2003; 9.1 percent).

In France, the construction industry is particularly badly affected, with 23.8 percent (prior year: 23.3 percent) of all insolvencies occurring in this sector, as compared with just 10.9 percent in Norway (prior year: 10.9 percent). On the other hand, Norway has a very high level of insolvencies in the service sector (44.8 percent), just like Germany (47.7 percent) and Belgium (44.6 percent).

Commerce was worst hit in Denmark: 42.6 percent (prior year: 42.5 percent) of all insolvencies. In Great

Britain the proportion was just 22.7 percent (2003: 19.1 percent).

■ 6 National reports

6.1 Great Britain

The number of business collapses in Great Britain increased in 2004 by 13.4 percent to 12,827. This was the biggest growth anywhere in Europe. The number of private insolvencies rose by 23.6 percent to 48,105.

Tab. 11: Insolvencies in Great Britain

■	2004	2003	Change in %
Total	60,932	53,747	+ 13.4
Companies	12,827	14,815	- 13.4
Private individuals	48,105	38,932	+ 23.6

On the economic front, Great Britain is the driving force in Europe. In 2004, it recorded economic growth of three percent, while the unemployment rate fell to an historic low of 4.8 percent. The rise in gross domestic product was fuelled by robust private consumption and an expansive fiscal policy. But the risks facing future economic development in Britain are made apparent by the alarming increase in consumer insolvencies. The level of consumer indebtedness is very high and is actually being stepped up by the sharp rises in the prices of already expensive housing. In 2001, the Personal Finance Research Centre had already indicated that 44 percent of British households are in danger of becoming over-indebted. The payment problems affecting these households primarily involve money owed to utilities and municipal authorities, with credit debts taking second place.

Brick bubble

6.2 Italy

Alongside Germany, Italy is the most export-oriented country in Europe. But economic growth in Italy in 2004, just as in Germany, was very weak (1.5 percent). The poor state of the German economy impacted negatively on Italian exports, and the country also faced domestic problems in important areas of

manufacturing. The Italian car industry for instance has seen its market share fall dramatically. Financial scandals and the economic damage caused by the bankruptcies of food companies Cirio and Parmalat also left scars and had an adverse effect on consumer and business confidence. On the labour front, though, the picture was somewhat more positive. Since 2000, unemployment in Italy has been falling, as a result of wage reticence, more flexible labour markets, tax incentives and the legalization of the "black economy".

Tab. 12: Corporate insolvencies in Italy

■	2004	2003	Change in %
	17,457	16,202	+ 7.7

The number of business insolvencies in Italy increased in 2004, by 7.7 percent to 17,457. This compares with 16,202 the year before.

6.3 Spain

In 2004 the Spanish economy grew by 2.7 percent, which was higher than the average for Europe as a whole. Since 1996, four million new jobs have been created in Spain, but all the same the unemployment rate, at 11.3 percent, is still the highest in Western Europe. Per capita income has now grown to almost 90 percent of the EU average.

A closer look, however, reveals that the Spanish economic miracle lacks a sound base. The boom has been fuelled entirely by credit-financed private consumption and lively construction activity. In industry, more than 100,000 jobs have already disappeared because more and more companies are moving production to Eastern Europe. In the course of globalization, the Iberian Peninsula has lost some of its attractiveness because in recent years wages have increased more strongly than productivity.

Credit-based consumption

Tab. 13: Corporate insolvencies in Spain

■	2004	2003	Change in %
	570	646	- 11.8

The decline in the volume of business bankruptcies is a reflection of the booming economy. Whereas in 2003, 646 companies applied for bankruptcy, the figure in 2004 was just 570, a fall of 11.8 percent.

6.4 France

With over 40,000 corporate collapses, France once again registered more insolvencies in the business field than all the other countries surveyed. However, at 4.6 percent, the rate of increase in 2004 was more moderate than before.

French economic growth, at 2.0 percent, was fuelled largely by private consumption. Exports on the other hand fell, because French exports go mainly to other Eurozone countries, where demand has been weak for some time now. French companies, especially the big ones listed in the CAC-40 index, are doing well. But job creation is low and in 2004 the unemployment rate was 9.7 percent – with joblessness especially high among young people.

France tops EU business insolvency charts

Tab. 14: Corporate insolvencies in France

■	2004	2003	Change in %
	40,042	38,296	+ 4.6

At the heart of French problems is the country's inflated civil service. This employs several million people and their trade union representatives fight fiercely against even the smallest cutbacks in the countless privileges. In contrast to most other OECD countries, which are seeking to cut state expenditure and streamline public authorities, France in recent years has pumped more and more money into the creation of jobs in the civil service, something that prompted Henri De Castries, president of insurer Axa, to say: "In this country it is the state that needs to be reformed."

■ 7 The Eastern enlargement of the EU: The new members

On May 1 2004, the European Union completed its biggest-ever expansion. With the accession of eight Eastern European countries and Malta and Cyprus, the division of the European continent has finally been overcome. The EU now comprises 25 member states. Following the admission of Poland, Hungary, the Czech Republic, Estonia, Latvia, Lithuania, Slovakia, Slovenia, Malta and Cyprus, the population of the EU has grown from 370 million to 455 million.

A fast pace

The states of Central and Eastern Europe are among the most dynamic regions in the world. The forecast growth rates for the new EU members in the period 2004-2007 are over four percent; in the case of the three Baltic countries, the figure is even higher, at over seven. This is well above the EU average. But there are considerable differences in regard to living standards and economic clout. Measured in terms of purchasing power, the per capita income of the new members is less than 50 percent of the average of the "old" EU. And the new member states are a very heterogeneous group. Whereas Malta and Cyprus can look back on a long market economy tradition, the other eight states only underwent the fundamental transformation from a socialist planned economy to free enterprise in the 1990s.

In this respect their laws, particularly regarding market entry and exit, are also relatively young, and do not function smoothly yet and the measures and instruments needed to enforce them are often lacking. Another factor is that corruption has not been brought under control yet. And there are still instances of politically motivated influence being exerted on business, of the kind seen in Russia with major oil exporter Yukos, which was forced to its knees by the state's "creative" use of insolvency law instruments to collect billions in alleged tax debts. Analysts see this tax dispute as a politically motivated move by the Russian government and President Putin to counter the political ambitions held by the former Yukos chief, Michael Chodorkowski.

In the new member states, the number of insolvencies usually reflects just the tip of the iceberg, because many companies which are already bankrupt by Western European standards are simply kept in existence as "corporate ruins". So Western European companies trading with firms in these countries face a real risk of being left with bad debts.

Tab. 15: Corporate insolvencies in Eastern Europe 2004 in comparison with the prior year *)

■	2004	2003	Change in percent
Poland	1,062	1,076	- 1.3
Slovakia	5,700	5,554	+ 2.6
Slovenia	1684	1,555	+ 8.3
Czech Republic	3,600	3,918	- 8.1
Hungary	7,756	7,693	+ 0.8
Latvia	796	1,339	- 40.6
Lithuania	700	611	+ 14.6
Total	21,298	21,746	- 2.1

*) unfortunately no figures are available for Estonia

The insolvency situation varies considerably

The number of business failures in the new member states (without Estonia) increased slightly, by 2.1 per cent to 21,298 firms.

Tab. 16: Insolvency ratios in individual Eastern European countries *)

■	Insolvencies per 10,000 companies
Poland	3
Czech Republic	16
Latvia	56
Hungary	90
Slovakia	107
Lithuania	112
Slovenia	269
Total	28

*) unfortunately no figures are available for Estonia

Insolvency ratios in the new member states vary substantially, which also makes comparisons difficult. In Poland only three in every 10,000 firms went broke in

2004, while the figure for Slovenia was 269. The average of the Eastern European countries is 28 insolvencies per 10,000 firms.

7.1 Poland

Polish foreign trade has developed dynamically in recent years, in respect of both imports and exports. The focus has shifted increasingly to the EU countries, with Germany a key partner. Low rates of income and corporate taxation give Poland clear-cut advantages in the international competition for business locations. This is the case with the other Central and Eastern European countries as well. In Poland, for instance, the rate of corporate taxation was cut from 27 percent in 2003 to 19 percent at present.

19.6 percent of Poland's working population are still employed in agriculture. Since last year, farmers with less than 1 hectare of land are automatically classified as unemployed and as a result of this statistical effect the current unemployment rate is 20 percent (2003: 18 percent). State expenditure in Poland is 46 percent of total output whereas fiscal income represents only 41 percent.

Insolvencies decline slightly

Tab. 17: Corporate insolvencies in Poland

■	2004	2003	Change in %
	1,062	1,076	- 1.3

On October 1, 2003, insolvency legislation in Poland was reformed, primarily with the aim of increasing the number of companies that could be rescued, but also to ensure that creditors get better settlements and to slim down proceedings. These efforts are still in their early stages, something indicated by the number of corporate insolvencies in Poland last year, which was just 1,062 (down 1.3 percent); this is less a reflection of the flourishing economy of the biggest new member state than an indication that the legal stipulations are being used only inadequately.

7.2 Slovakia

Economic growth in Slovakia in 2004 was around 4.1 percent. The private sector contributed almost 90 percent to gross domestic product. Despite its booming economy, Slovakia suffers from a high unemployment rate, 16.6 percent. The slow process of privatization and a lower inflow of foreign capital have delayed the restructuring of businesses. And the use of resources, particularly of power, in the industrial sector in Slovakia is still substantially higher than in Western economies. Price liberalization and tax increases made the inflation rate in 2004 rise strongly, by 8.8 percent.

Tab. 18: Corporate insolvencies in Slovakia

■	2004	2003	Change in %
	5,700	5,554	+ 2.6

In 2004, there were 5,700 corporate insolvencies in Slovakia, 2.6 percent more than in 2003. The country's insolvency regulations do not provide any scope for corporate rescue, so a bankruptcy automatically means that the firm involved disappears. However there are efforts underway to carry out a fundamental reform of the present insolvency law in order to eliminate corruption, to speed up proceedings and introduce the possibility of corporate restructuring for distressed firms.

Keeping firms alive

7.3 Slovenia

Rating agencies put Slovenia in first place among Central and Eastern European countries. One reason is the relatively low unemployment rate (of 6.4 percent) and the high level of education (Slovenians are the most diligent internet users, with an average of 376 users per 1,000 inhabitants in 2000 as compared with the Western EU-average of just 355). The country also has comparatively little corruption, dependable judicial systems and relatively good protection for debtors.

Tab. 19: Corporate insolvencies in Slovenia

■	2004	2003	Change in %
	1,684	1,555	+ 8.3

The number of corporate insolvencies in Slovenia increased last year by 8.3 percent to 1,684, which is a relatively high figure given a population of only just on two million. On the other hand, it also shows that the relevant laws appear to function.

7.4 Czech Republic

In the Czech Republic the growth anticipated for 2004 was four percent. This figure, high by Western European standards, was due to the good consumer climate, the positive development of exports and the fact that foreign companies continue to invest substantially in this country. But there are worries relating to the recent revaluation of the Czech koruna vis-à-vis the US dollar. In August last year, against the background of increasing inflation and accelerated growth, the Czech Central Bank increased the key interest rate, to a moderate 2.5 percent, But further rises are likely to follow. One disadvantage of this country is the length of time taken by bureaucratic processes and judicial proceedings. Getting a claim judicially enforced in the Czech Republic takes 300 days on average, while the EU average is just 229 days.

Bureaucratic insolvency legislation

Tab. 20: Corporate insolvencies in the Czech Republic

■	2004	2003	Change in %
	3,600	3,918	- 8.1

Insolvency proceedings in the Czech Republic are even more protracted. On average it takes more than nine years to wind up a bankrupt business. The number of insolvencies in the Czech Republic is on the decline. After 3,918 cases in 2003, the figure for 2004 was 3,600, equivalent to a fall of 8.1 percent.

7.5 Hungary

The Hungarian economy has been on a growth trajectory for eight years now. This is driven by exports by the country's industry, which has been modernized mainly with the help of foreign investment. Now, though, following the virtual completion of privatizations and stiffer competition in the region in the wake of EU admission, there has been a marked decline in such investment. The economic policy of the Medgyessy government is aimed at overcoming this and it has launched a number of initiatives intended to draw on Hungary's traditional strengths in technical and IT expertise.

Tab. 21: Corporate insolvencies in Hungary

■	2004	2003	Change in %
	7,756	7,693	+ 0.8

In Hungary, collecting debts is difficult. Most debtors do not even react to out-of-court dunning letters, and the activity of debt collection companies has not yet been legally clarified. As a result that there are numerous smallish firms operating in this field with illegal methods or which simply disappear with the collected money afterwards. Judicial dunning proceedings cost three percent of the sum at stake, while legal proceedings cost six percent. As a general rule, going through the courts takes one or two years, and so it is not rare for the debtor to have become insolvent in the meantime.

If an insolvency case does go to court, which in 2004 happened 7,756 times (up 0.8 percent on 2003), in 90 percent of cases the proceedings are not even opened because of a lack of sufficient assets to cover the costs. In such cases, creditors get nothing. Corporate rescue proceedings also rarely bear fruit, since Hungary has little experience with such instruments and the appropriate legal structures are not available.

Creditors' rights are poorly regulated

7.6 The Baltic states: Estonia, Latvia and Lithuania

The three small Baltic States are attracting attention, because they exhibit largely balanced state budgets, strong economic growth, high current account deficits and a high level of professional education.

Tab. 22: Corporate insolvencies in the Baltic States *)

■	2004	2003	Change in %
Latvia	796	1,339	- 40.6
Lithuania	700	611	+ 14.6

*) unfortunately no figures are available for Estonia

In Estonia, the estimated economic growth in 2004 was 5.6 percent. The country traditionally has strong links with Finland, which is by far its most important trading partner. Obstacles to further growth are the still unsatisfactory state of road routes to Western Europe and the fact that corruption is still prevalent.

In Lithuania, the strong expansion of foreign trade and the fact that admission to the EU has made it easier to import consumer goods from Western Europe have led to a drastic rise in the country's current account deficit. In the first half of 2004, this amounted to 10 percent of GDP. However, foreign direct investment in Lithuania totalled 382 million euros. Nonetheless, the average standard of living in Lithuania is just 42 percent of the EU average. For this reason, emigration is still high, and in the first seven months of 2004, 54 percent more people emigrated to Western Europe than in the corresponding prior-year period. The number of insolvencies rose relatively strongly, by 14.6 percent to 700.

In Latvia, GDP in 2004 grew by around six percent. 70 percent of this is generated in the services sector and just one fifth by industry. In March 2004, the official unemployment rate was 9.2 percent. Some social welfare elements have been implemented, such as minimum wages, unemployment benefits, protection from dismissal, sick pay and old-age pensions, but developing these further is coming up against financial

Deterioration in Lithuania

boundaries. But the country's insolvency law dates back to 1996. In the course of last year, the number of insolvencies fell by 40.6 percent to 796.

■ **8 Insolvencies in Japan and the USA**
8.1 Japan

Almost right through to the end of 2004, there were no signs of any slowdown in the process of economic recovery in Japan. GDP growth was 2.9 percent, driven above all by exports which were in turn fuelled by the explosive development of the Chinese economy and the strong domestic demand for digital products. Reflecting the economic development was the sharp drop in the number of business insolvencies, which fell by 16.2 percent in the course of the year to 13,934.

*Economy improving,
fewer insolvencies*

Tab. 23: Corporate insolvencies in Japan

■	2004	2003	Change in %
	13,934	16,624	- 16.2

However, in the final months of 2004, there were increasing indications of a cooling-off in the Japanese economy. In particular in October and November, there were declines in the exports of digital equipment and also in private consumption. But experts assume that this phase will be relatively short-lived. Overall, the business sector in Japan is very strong and the Bank of Japan is well on its way to solving the problem of the non-performing loans which affect a number of banks. One factor making this easier is that property prices are stabilizing – and it property which is most frequent used to secure credit.

8.2 USA

The world's biggest economy grew by 4.5 percent in 2004. Tax breaks, the inflow of foreign capital and low interest rates all helped to boost private consumption and investment. The number of corporate insolvencies in the USA rose only moderately, by 0.4 percent to 35,185 (2003: 35,037).

***A source of danger:
consumer indebtedness***

In the USA, around two-thirds of gross domestic product is generated by private consumption; there is no sign of the consumer reticence found in Germany. But this is also where the dangers for the American economy lie: private indebtedness in America is at a record-breaking level. According to the Fed, loans taken up by Americans in Q1 2004 to finance real estate, buy cars and for other private expenditure totalled nine trillion dollars. The average American has to spend 18.4 percent of his income on paying off his debts. Living off credit was no problem as long as interest rates were at an historic low. Massive borrowing to buy housing triggered an unprecedented property boom in recent years. Many Americans quickly sold off their houses again at a high profit. But since the Fed started increasing interest rates in summer last year, many Americans are in danger of being trapped in debt. About one fifth of all private loans are on the basis of variable interest rates, so many Americans have to pay back more and more every month.

Unlike in Germany, consumers in the USA borrow money not just to purchase long-life consumer goods but also for, for instance, to financing the costs of medical treatment. In 2000 for instance, 56.2 percent of all married couples who made a joint application for the opening of private bankruptcy proceedings had obtained loans to pay for medical treatment.

Tab. 24: Insolvencies in the USA

■	2004	2003	Change in %
Total	1,644,492	1,659,714	- 0.9
Corporate	35,185	35,037	+ 0.4
Private individuals	1,609,307	1,624,677	- 0.9

Impoverished middle classes

Three studies, carried out at ten-year intervals, of debtors facing private insolvency proceedings highlighted another phenomenon: it is particularly middle-class Americans who go broke – in 2001 they accounted for 91.8 percent of all applicants for bankruptcy. When bankruptcy proceedings were actually opened, most of these people were in the lower income brackets, although they had started out in the

middle class. This fact alone helps to explain what caused the insolvency: a drop in income as the result of unemployment, short-time working etc. If the bankruptcy candidates are compared with the general US population in terms of professional training, they quite evidently belong to the educated middle classes.

■ 9 Summary

The number of corporate insolvencies in the European Union plus Norway and Switzerland rose slightly in 2004, by 1.0 percent to 156,245 (prior year: 154,647). But the way insolvency figures developed in different countries varied considerably.

The biggest decline was posted by Great Britain, where the volume of insolvencies fell by 13.4 percent to just under 13,000. Norway was also able to reduce its bankruptcy total, from 3,084 in 2003 to 2,675 in 2004, equivalent to a fall of 13.3 percent. Spain was another country to register a double-digit decrease (minus 11.8 percent), but in this field Spanish figures are not really comparable with those elsewhere. In 2004, for instance, there were only 570 business insolvencies in Spain, mainly because the relevant laws are used only by large companies, while smaller firms simply continue to exist, as "ruins", to avoid the expense of any winding-up proceedings.

At the other end of the scale lies Greece, where the number of corporate insolvencies rose by 20.2 percent. In all, 577 companies applied for bankruptcy. In second and third place were Germany's neighbours Austria (11.2 percent increase, 6,273 affected companies) and Switzerland (9.2 percent rise to 4,955 insolvencies).

The highest insolvency ratio (the number of insolvencies in relation to the total number of companies) was registered in Luxembourg, with 280 insolvencies for every 10,000 firms. For the reasons described above, Spain had the lowest insolvency ratio with just two out of every 10,000 companies applying for bankruptcy.

Not all European countries have data on the number of insolvencies by private individuals. However, the development is clear-cut: the number of such cases continued to grow unabated in 2004, rising by 22.5 percent to 139,989. The only country to buck this trend was Norway, where the number of consumer insolvencies fell to just 1,685 in 2004 after 2,139 the year before, equivalent to a drop of 21.2 percent.

In Germany, the hoped-for trend reversal on the corporate insolvency front failed to materialize in 2004 but the rise in the volume, at 0.3 percent, was extremely moderate (39,600 cases). On the other hand, the number of private insolvencies reached 76,100, which was almost twice as high as the volume of business failures and represented a 25 percent increase on the year before.

The ongoing rise in the number of corporate insolvencies is due chiefly to two factors: inadequate financial resources and the general economic environment. Whereas in Spain small and medium-sized enterprises have an equity ratio of 41 percent on average and are thus relatively well capitalized, the situation in Italy (22 percent on average) and Germany (20 percent, according to the BDI industry federation) is much poorer.

Impacting adversely on business in Italy is the fact that invoices are settled only very slowly: on average customers take 87 days to pay their bills – the longest payment period in Europe. In Germany, invoices are generally settled within 42 days – but even that kind of delay can place a severe strain on the liquidity of small firms.

The number of jobs threatened by corporate insolvencies in 2004 was 1.6 million. The year before it was 1.7 million.

In Western European countries, the insolvency scene is dominated by the service sector, which accounts for 44.7 percent of the total (prior year: 42.9 percent). Commerce (wholesale/retail) contributes 26.5 percent to the volume of business collapses (prior year: 25.3

percent), the construction industry 18.6 percent (2003: 20.6 percent), while only 10.2 percent of all bankruptcies are in manufacturing (2003: 11.2 percent).

For the second time in succession, this survey by the Creditreform Economic Research Unit also covers the insolvency situation in the new EU member states of Central and Eastern Europe. This varies considerably. In Latvia for instance, business failures fell by 40.6 percent to 796; in Lithuania they rose by 14.6 percent to 700.

Overall, the seven new member countries from Central and Eastern Europe (no figures are available for Estonia) posted a decline of 2.1 percent (or 488 firms) in the volume of insolvencies to a total of 21,298. It must be noted that in these new member states full use is not yet being made of the relevant laws. So it must be assumed that there are many more insolvent firms, which by Western European standards would no longer be allowed to operate.

Corporate insolvencies in Japan fell by 16.2 percent last year to 13,934. In the USA, the figure rose very slightly, by 0.4 percent. However, the US total of 35,185 business collapses is still far below that in Germany or France. On the other hand, every year in the USA well over one million private individuals go to the courts to declare bankruptcy. The figure in 2004 was 1,609,307, which was in fact 0.9 percent down on the year before.

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