

FRANCE: ECONOMIC WEIGHT OF CORPORATE BANKRUPTCIES: HIGH LEVELS TO BE PUT INTO PERSPECTIVE

Thomas Humblot

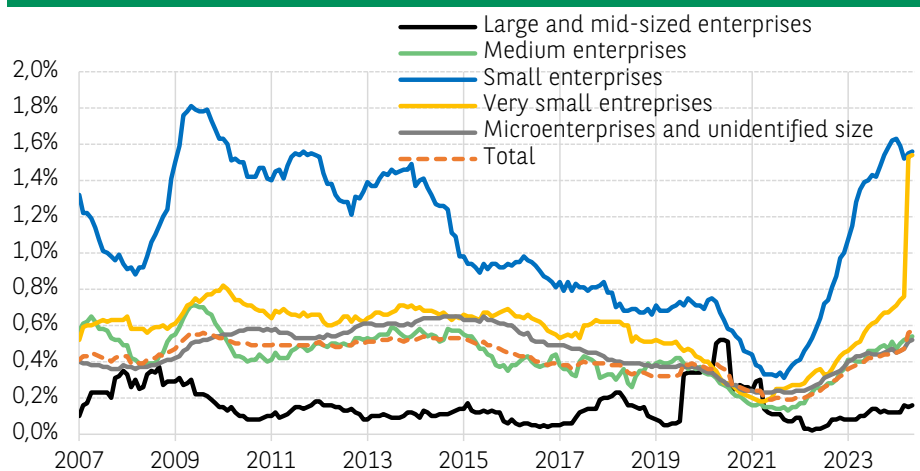
Like their number, the economic weight of corporate bankruptcies has increased to an unprecedented extent since March 2022, starting from an all-time low in 2021.

This ratio compares the outstanding amount of bank loans to newly bankrupt corporates¹ to the total outstanding amount of bank loans to corporates (in difficulty or not).

These developments are mainly due to the continued catch-up of corporate bankruptcies. This concerns more fragile corporates whose would have already gone bankrupt in the absence of the economic and health measures put in place in response to the COVID-19 pandemic.

Furthermore, the repayment of State-Guaranteed Loans does not seem to have an excessive impact on the financial situation of the majority of corporates that have benefited from them.

ECONOMIC WEIGHT OF CORPORATE BANKRUPTCIES* BY SIZE



*Legal units, outstanding amount of bank loans mobilised by bankrupt corporates, the month in which the Commercial Court orders the opening of a receivership or a judicial liquidation proceeding, as a share of the outstanding amount of bank loans drawn by all corporates of the size in question, monthly rates cumulated over 12 months.

CHART 1

SOURCE: BANQUE DE FRANCE, BNP PARIBAS

In addition, the number of corporates founded increased sharply between 2016 and 2021, which also helps explain the increase in the number of bankruptcies. The analysis of the economic weight of the latter makes for more relevant reading than that from merely observing their number (especially when bankrupt corporates are distinguished according to their size) because it gives a better account of their impact on banks. In any case, French banks largely appear in a position to absorb this increase in their cost of risk, which is mainly attributable to small corporates. Indeed, banks' net interest income should benefit from the easing of monetary policy and the drop in short-term interest rates. Finally, their equity far exceeds the prudential requirements and recommendations.

¹ The collective proceedings identified by INSEE apply to bankrupt corporates (in cessation of payments) and only to them. The legislator defines cessation of payments as the impossibility of meeting the liability due with the assets available (Article L.631-1 of the French Commercial Code). Receivership and judicial liquidation are two remedial measures that differ from the safeguard procedures introduced in 2005. The safeguard procedures apply preventively to corporates in difficulty but not yet bankrupt and never to corporates in cessation of payments. They constitute the third type of collective proceedings and are not recorded statistically by INSEE, which only records receiverships and judicial liquidations. There is also a time lag between the bankruptcy itself and the ruling beginning collective proceedings. INSEE therefore bases its bankruptcy count on the ruling date. The Banque de France counts them by legal units because legal proceedings are generally opened at this level. Corporates (and more precisely "enterprises"), as defined by Law No. 2008-776 on the modernisation of the economy of 4 August 2008 (LME Law), constitute the smallest possible combination of legal units.

THE UNPRECEDENTED MAGNITUDE OF THE INCREASE IN THE ECONOMIC WEIGHT OF CORPORATE BANKRUPTCIES IS DUE IN PARTICULAR TO A CATCH-UP PHENOMENON

Since March 2022, the outstanding amount of bank loans drawn by bankrupt corporates, in the month in which the Commercial Court orders the opening of a receivership or a judicial liquidation proceeding, has shown an increasing proportion of the total outstanding amount of bank loans drawn by all corporates, whether or not they are in difficulty (see *Chart 1*). Starting from a historical low around 0.2% year-to-date² between April 2021 and March 2022, this economic weight of legal units placed in receivership or judicial liquidation stood at 0.57%³ year-to-date in May 2024, exceeding its historical August 2009 peak (0.56%). It has thus been above its 2010-2019 average since February 2024 (0.45%). While observations since mid-2023 have suggested that the economic weight of bankruptcies began to stabilise, those of April and May 2024 contradicted this outlook.

Just like the magnitude of the increase in the number of corporate bankruptcies (cf. below), that of their economic weight is unprecedented (+38 basis points between November 2021 and May 2024 compared to a maximum of +17 bp during the 2008-2009 crisis). This can be explained, in particular, by a "catch up effect on the backlog of corporate bankruptcies"⁴. The physical reopening of the Commercial Courts after the first lockdown (17 March 2020 - 11 May 2020) enabled the gradual processing of corporates in difficulty that had accumulated during this period. Despite the implementation of online procedures, only 1,394 bankruptcies were recorded in April 2020, an all-time low since 1990, with a monthly average of 4,903 between 2010 and 2019. In addition, the gradual lifting of the measures to ease the law on companies in difficulty,⁵ some of which had been extended until December 2021, helped to temporarily increase the characterisation of bankrupt corporates. More generally, the expiry of social and fiscal maturity postponements, the furlough scheme or tax rebates, among other public measures, also contributed to the increase in the number of bankruptcies after having appropriately, but also artificially, reduced them.⁶

THE REIMBURSEMENT OF STATE-GUARANTEED LOANS DOES NOT GENERALLY CAUSE CORPORATES' SITUATIONS TO DETERIORATE

Between March 2020 and March 2021, banks granted EUR 135 billion in State-Guaranteed Loans, representing 57% of the outstanding amount of treasury loans to non-financial corporations in February 2020.

² This involves totalling, over a year, the amount of outstanding bank loans to newly bankrupt corporates, in the month in which the Commercial Court orders the opening of a receivership or a judicial liquidation proceeding, and comparing it to the average outstanding amount of bank loans to healthy corporates and those bankrupt during that same period.

³ According to the Banque de France, the magnitude of the increase in April 2024 can be explained largely by the bankruptcy of a single very small enterprise (VSE), which led the economic weight of bankrupt VSE to reach 1.56% compared to 0.85% without it.

⁴ Banque de France, 2024, *Business failures - France*, May 2024.

⁵ Order No. 2020-341 of 27 March 2020 adapting the rules relating to the difficulties of companies and agricultural holdings to the health emergency and amending certain provisions of criminal procedure and Order No. 2020-596 of 20 May 2020 adapting the rules relating to the difficulties of companies and agricultural holdings to the consequences of the COVID-19 epidemic.

⁶ And most likely prevented the transient difficulties of some corporates from becoming permanent and increasing the number of bankruptcies.

⁷ See in particular, Bpifrance - LeLAB, 2024, *78th SME economic survey*, January.

⁸ Court of Auditors, 2022, *Les prêts garantis par l'État - Une réponse efficace à la crise, un suivi nécessaire*, Themed Public Report, Public Policy Assessments, July.

⁹ The scope of which is more restricted than that of all corporations.

ENTERPRISE BANKRUPTCIES BY SIZE (CUMULATED OVER 12 MONTHS)

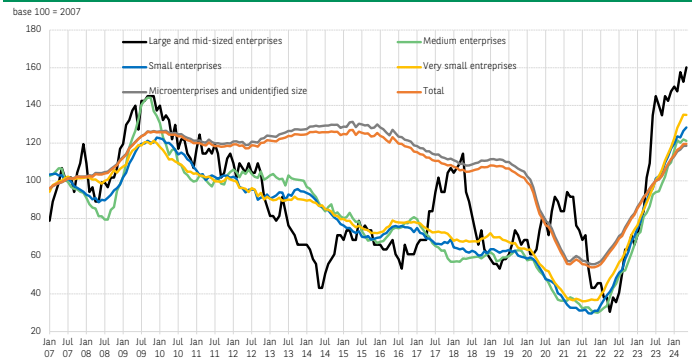


CHART 2

SOURCE: BANQUE DE FRANCE, BNP PARIBAS

ENTERPRISE REGISTRATIONS AND BANKRUPTCIES (CUMULATED OVER 12 MONTHS)

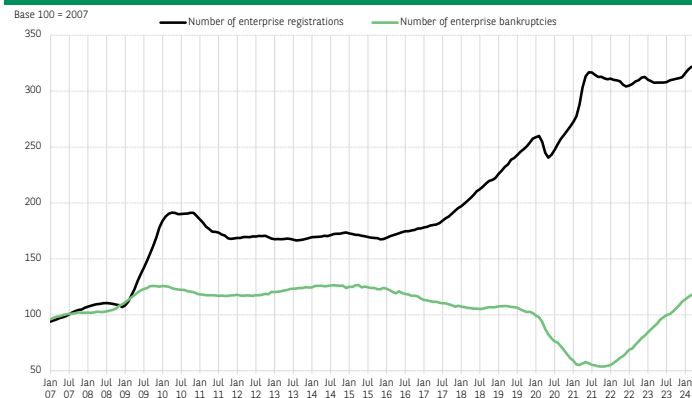


CHART 3

SOURCE: BANQUE DE FRANCE, BNP PARIBAS

The start of the reimbursement of State-Guaranteed Loans, mainly from Q2 2021, does not seem to have contributed significantly to the increase in the number of bankruptcies. Indeed, only 4% of managers of small and medium-sized enterprises that benefited from at least one State-Guaranteed Loan consider that they will not be able to repay it, three years after it was taken out.⁷ In December 2021, the rapporteurs of the Court of Auditors⁸ thus estimated the probability of State-Guaranteed Loan default at between 3.1% and 4.2%. At the same date, the non-performing loans ratio of non-financial corporations⁹ stood at 3.5% (and 3.6% in the fourth quarter of 2023).



The small gap between the default rate of “traditional” loans and that of State-Guaranteed Loans can be explained in particular by the exclusion of the scheme for companies already in difficulty before the pandemic. In addition, banks applied their usual criteria for granting loans¹⁰ despite a low rejection rate (2.9%¹¹). Some corporates in a healthy financial situation have adopted opportunistic behaviour to build up a cash reserve since the State-Guaranteed Loans were granted at cost price, with a maturity of up to 5 years and a one-year moratorium on repayments. Thus, 35% of corporates that obtained a State-Guaranteed Loan had not “used” half of it by Q4 2023. At the end of November 2023, 52% of the amounts disbursed had been repaid.¹² However, the repayment of State-Guaranteed Loans helped to stabilise the outstanding amount of loans drawn by non-financial corporations, which settled at the same level in April 2024 as in November 2023 (EUR 1,358 billion) after four months of decline. Measured in terms of ratio, the increase in the economic weight of corporate bankruptcies is thus, to a modest extent, the result of the stabilisation of the denominator made up of outstanding loans to non-financial corporations. Corporate cash flow still appears to be sufficient, on average, while access to lines of credit granted by banks remains relatively easy in 2024.¹³

CORPORATE BANKRUPTCIES: THEIR ECONOMIC WEIGHT COULD INCREASE ALONG WITH THEIR NUMBER

The number of corporate bankruptcies has exceeded its annual average for 2010-2019 (59,342, see *Chart 2*) since April 2024 (60,159, year-to-date, then 60,210 in May¹⁴). There were only 27,222 bankruptcies at the historic low in October 2021. The Banque de France thus estimates that around 50,000 bankruptcies were “missing” between 2020 and 2023. In this respect, the catch-up in the delay in bankruptcies of corporates that, while not bankrupt before the COVID-19 pandemic, were vulnerable and would have ended up struggling in the absence of support measures, still appeared incomplete in May 2024. Indeed, it assumes above-average figures before a return to the latter. The continued catch-up of the number of bankruptcies could, despite an imperfect correlation, lead to an increase in their economic weight.

A further increase in the number of bankruptcies is highly likely. On the one hand, some already vulnerable corporates would have gone bankrupt without the public, health and economic measures put in place in response to the COVID-19 pandemic. On the other hand, the post-pandemic war in Ukraine worsened the situation of a number of corporates. All suffered, to varying degrees, from the increase in the price of inputs, largely linked to the energy component, which played a considerable role in inflation (beyond core inflation), as well as the narrowing of bottlenecks. More generally, they suffered the inflationary shock, which after being transient with the ebb of the pandemic, became more lasting with the war in Ukraine.

Finally, the number of corporates founded, and therefore potential subsequent bankruptcies, has increased sharply since 2016 (cf. *Chart 3*). Between 2010 and 2015, there were 581,857 corporates founded on average each year, compared to 947,092 between 2018 and 2023 — an increase of 63%. Assuming that the rate of bankruptcies remains constant, a higher number of bankruptcies is therefore not necessarily a sign of a higher default rate.

SMALL BUSINESSES HAVE CONTRIBUTED SIGNIFICANTLY TO THE ECONOMIC WEIGHT OF BANKRUPTCIES

The economic weight of small bankrupt enterprises is by far the highest among the various sizes of business, with the exception of the exceptionally high April 2024 figure for very small enterprises. In May 2024 it stood at 1.56% for small enterprises after falling slightly in February and March 2024 limiting its one-year increase to 17 basis points, reaching the same level as in October 2023 and September 2011. It could thus remain below the historical peak (1.81%) reached in May 2009. An increase in the economic weight of small bankrupt enterprise greater than that of other company sizes appears to be a historical regularity.

On the other hand, the economic weight of bankruptcies by large and medium-sized enterprises contributed little to the overall trend. It has risen significantly from an all-time low (0.16% in May 2024 compared to 0.02% in April 2022 for a 2010-2019 average of 0.12%), but remains structurally well below the economic weight of corporate bankruptcies seen as a whole. This very modest increase contrasts with the more substantial increase in the cumulative number of bankruptcies over 12 months of large and medium-sized enterprises. Their rate of increase was still +47% in May 2024 after peaking at +279% in June 2023. The large and medium-sized corporates that newly went bankrupt are therefore smaller and/or have less outstanding loans than the average of large and medium-sized enterprises that went bankrupt in the past.¹⁵ Finally, the magnitude of the increase in the number of large and medium-sized bankrupt enterprise must be assessed, above all, in view of their low absolute number, which multiplies the marginal effect of each bankruptcy (63 year-to-date in May 2024 compared to 12 during the last low in April 2022 and 33 on average between 2010 and 2019). As the starting point is very low, the economic weight of large and medium-sized enterprises that newly went bankrupt is likely to be very different from that of large and medium-sized enterprises that went bankrupt in the past. The discrepancies between new and old bankruptcy statistics are likely to be much greater than for all companies that are subject to greater statistical regularity due to a much higher number of bankruptcies. Finally, it would have been interesting to calculate the contribution of each size of corporate to the total economic weight of bankruptcies, if data with a sufficient level of disaggregation were available.

¹⁰ Nicolas et al., 2023, *Public-guaranteed loans, bank risk-taking and regulatory capital windfall*, Economic and financial debates No. 41, ACPFR.

¹¹ Court of Auditors, 2022, *Les prêts garantis par l'État - Une réponse efficace à la crise, un suivi nécessaire*, Themed Public Report, Public Policy Assessments, July.

¹² Banque de France, 2024, *La médiation du crédit - Une vigilance renforcée*, CCI Ile de France, 8 February.

¹³ See in particular, Banque de France, 2024, *Access to bank financing for companies 2024 Q1*, Stat info.

¹⁴ Provisional data.

¹⁵ In July 2023, no large corporate bankruptcy had been recorded over a year (cf. Gonzalez, O., 2023, *Quel est l'impact économique des défaillances d'entreprises ?*, Bulletin de la Banque de France, 24876 - September-October).



The continued catch-up of the delay in bankruptcies (temporarily avoided by the implementation of public support measures in response to the COVID-19 pandemic) and the sharp increase in businesses founded between 2016 and 2021 help explain the record increase in the number of corporate bankruptcies and in their economic weight. Our growth forecasts for the French economy (0.7% in 2024 after 0.9% in 2023) suggest that these bankruptcies could reach unprecedented new levels. The latter must be put into perspective by the rise in the corporate population. Incidentally, the growth rate of bankruptcies, whose year-on-year trend went from a peak of 53% in January 2023 to 25% in May 2024, is expected to fall, as is their economic weight. The rate cut, which the ECB just began on 6 June 2024, will also help ease the financial expenses of companies, which are mainly indebted at floating rates, and more so in terms of "bank loans". This gradual normalisation of bankruptcies will limit the increase in the cost of risk for French banks. The deterioration in the average creditworthiness of households due to the moderate impact of bankruptcies on employment and the granting of almost exclusively fixed-rate loans for house purchase should, as is, only have a limited effect on the non-performing loan ratios, which should remain at low levels.

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