

# Insolvencies in Europe

2002/03

A survey by the  
Creditreform Economic  
Research Unit

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## ■ 1 Introduction

From the economic angle, 2002 was not a good year. For a start, hopes that the capital markets would pick up again and that there would be a recovery in the level of business activity were disappointed. Then there was also the historic low reached in the field of corporate stability, with the number of company collapses in Germany and elsewhere at a higher point than at any time since the second half of the last century. In particular the incidence of big corporations going bankrupt was virtually unprecedented. One English-language paper caustically pointed out that 2002 brought the USA, for instance, its biggest, second-biggest and fourth-biggest insolvencies ever. That list was topped by Enron; the German equivalent was the collapse of the Kirch media empire. The impact of such major business failures is both direct – affecting creditors, employees, banks, suppliers and investors – but also, and even more significantly, indirect, in the way that they destroy trust and confidence. They highlight the fact, for example, that the faith placed in technical progress was unjustified. Kirch and Enron demonstrate that the times are evidently not yet ripe for Pay-TV or energy trading via the Internet. But betting on the wrong horse is part and parcel of the market economy, with insolvency as the penalty. And accepting all the hype at face value is the sure path to financial ruin.

What made everything worse, though, was the revelation of the extent of manipulation and even fraud and embezzlement that preceded some of the big bankruptcies. This in turn made it evident that the control mechanisms simply had not functioned, and that also damaged confidence in the economy.

The shortcomings of the much-lauded CEO system, which only just before had been cited as a role model for management in Germany were revealed. Critical attention was drawn to accounting in line with US-GAAP and to the valuation of stock options. In Germany, the focus was on corporate structures which impair transparency by creating a dense tangle of in-

***Insolvencies determine the climate***

## ***Belief in the market economy***

terlocking and interlocked companies and demonstrate that the semblance of personal liability is in fact a sham. From supervisory boards to auditors and accounting rules – it seemed that everything had to go back to the test bench.

Insolvencies form part of a vicious circle. They unsettle banks and the financial markets, investors and partners. The money required for financing measures is available – but no-one is prepared to put it where it's needed. The word credit comes from “credere”, “to believe”. But belief in the free market economy has now been severely shaken. This leads to the bonds issued by large companies being downgraded, but also makes it more difficult for small and medium-sized enterprises to secure financing from their house bank. The “house bank principle” itself has been affected by the massed insolvencies among SMEs, perhaps even more that it has been by Basel II.

What is essential now is to stop this downward spiral and stop insolvencies growing in both size and number. For this, it is necessary to re-examine, modify and perhaps even replace the rules of corporate governance.

## ■ **2 Insolvencies in Europe**

### **2.1 Insolvency figures for 2002**

There were far more insolvencies in Western Europe in 2002 than the year before. This applies both to the overall number, i.e. including private bankruptcies, and to business collapses. The overall total of 241,000 represents a rise of 21.7 percent on 2001, when the figure was 198,000.

**Tab. 1: Insolvencies in Europe 1997 - 2002**

■	Absolute						Changes in percent				
	1997	1998	1999	2000	2001	2002	97/98	98/99	99/00	00/01	01/02
Austria	6,400	7,319	8,934	9,006	8,777	9,023	14.4	22.1	0.8	- 2.5	2.8
Belgium	7,700	6,925	7,150	6,791	7,062	7,121	- 10.1	3.2	- 5.0	4.0	0.8
Denmark	1,800	1,800	1,586	1,732	2,189	2,472	0.0	- 11.9	9.2	26.4	12.9
Finland	3,611	3,136	3,080	2,908	2,793	2,904	- 13.2	- 1.8	- 5.6	- 4.0	4.0
France	61,068	55,000	41,186	37,449	34,876	38,688	- 9.9	- 25.1	- 9.1	- 6.9	10.9
Germany	33,398	33,977	33,870	41,780	49,510	82,400	1.7	- 0.3	23.4	18.5	66.4
Greece	1,300	871	694	636	591	512	- 33.0	- 20.3	- 8.4	- 7.1	- 13.4
Ireland	550	686	815	344	427	379	24.7	18.8	- 57.8	24.1	- 11.2
Italy	14,878	15,000	14,760	15,000	15,200	15,600	0.8	- 1.6	1.6	1.3	2.6
Luxembourg	425	423	545	597	750	695	- 0.5	28.8	9.5	25.6	- 7.3
Netherlands	5,547	5,031	3,920	3,726	5,832	6,358	- 9.3	- 22.1	- 4.9	56.5	9.0
Norway	3,300	3,347	3,342	3,576	3,541	4,276	1.4	- 0.1	7.0	- 1.0	20.8
Portugal	621	783	999	1,308	1,594	1,924	26.1	27.6	30.9	21.9	20.7
Spain	1,135	896	620	602	335	448	- 21.1	- 30.8	- 2.9	- 44.4	33.7
Sweden	11,000	9,200	7,261	7,301	8,012	8,387	- 16.4	- 21.1	0.6	9.7	4.7
Switzerland	9,190	8,850	8,490	8,300	8,145	8,802	- 3.7	- 4.1	- 2.2	- 1.9	8.1
UK	37,000	37,500	46,900	47,404	48,397	50,988	1.4	25.1	1.1	2.1	5.4
<b>Total</b>	<b>198,923</b>	<b>190,744</b>	<b>184,152</b>	<b>188,460</b>	<b>198,031</b>	<b>240,977</b>	<b>- 4.1</b>	<b>- 3.5</b>	<b>2.3</b>	<b>5.1</b>	<b>21.7</b>

This year, our insolvency survey for the first time separates business failures from overall insolvencies as far as the past two years are concerned. A look at Germany makes the reason for this apparent: the number of private bankruptcies is now overtaking the business insolvency total. Of the insolvency total, 82,400 in 2002, 37,700 involve business failures, which in this country includes not just firms in the commercial register but also small traders. In Germany as in many other European countries, there is a grey zone in which micro-enterprises may fall under the law governing businesses, or traders may be regarded as private individuals. Another factor is that in many countries natural persons cannot file for bankruptcy or at least are not included in insolvency statistics. So in some countries, the overall insolvency total corresponds to the number of business collapses (for example in France); in others, the two figures can be very different (as in the UK or Germany).

***Private and business bankruptcies***

The number of business bankruptcies in Western Europe increased by around 15,000. In 2001, there were 135,800; in 2002 the figure was 150,300 (up 10.7 percent).

**Tab. 2: Business insolvencies in Europe 2002**  
(in comparison with the year before)

■	2001	2002	Change in percent
Austria	5,178	5,254	+ 1.5
Belgium	7,062	7,121	+ 0.8
Denmark	2,189	2,472	+ 12.9
Finland	2,077	2,802	+ 34.9
France	34,876	38,688	+ 10.9
Germany	32,390	37,700	+ 16.4
Greece	591	512	- 13.4
Ireland	427	379	- 11.2
Italy	15,200	15,600	+ 2.6
Luxembourg	750	695	- 7.3
Netherlands	4,329	4,802	+ 10.9
Norway	2,174	2,507	+ 15.3
Portugal	1,594	1,924	+ 20.7
Spain	335	448	+ 33.7
Sweden	7,433	7,819	+ 5.2
Switzerland	3,613	4,800	+ 32.9
UK	15,574	16,752	+ 7.6
<b>Total</b>	<b>135,792</b>	<b>150,275</b>	<b>+ 10.7</b>

**Substantial increase in  
business failures**

This survey covers the same number of countries as in previous years: those of Western Europe, including the non-EU members Norway and Switzerland.

All these countries registered a rise in the volume of insolvencies, with the exception of Greece, Ireland and Luxembourg where the figures fell by 13.4 percent, 11.2 and 7.3 percent respectively. Particularly notable increases were recorded by Germany (66.4 percent), Spain (33.7 percent), Norway (20.8 percent) and Portugal (20.7 percent). The biggest European economies also have the biggest overall insolvency totals: Germany (82,400), United Kingdom (50,988), France (38,688) and Italy (15,600) together account for around three-quarters of the European total. This quartet also dominates the business bankruptcy fig-

ures. In these four countries together, some 108,600 companies became insolvent, equivalent to over two-thirds of all the business collapses in Europe. The overall figure corresponds to their share of the EU's gross domestic product: in 2000, the big four were responsible for 6,130 billion of the 8,526 billion euros generated within the EU, i.e. around three-quarters of the total volume.

***Large economies,  
high insolvency totals***

The insolvency wave in Western Europe started to get underway in 2001, even though that year there were still six countries posting lower totals than the year before. Interestingly, two of the countries which reported higher overall insolvency figures in 2001 – Luxembourg (up 25.6 percent) and Ireland (up 24.1 percent) – last year reversed this trend. However, in view of the very low absolute totals involved – Ireland just 48 overall insolvencies fewer, Luxembourg 55 – these results are hardly representative.

That certainly does not apply to France, though, and its figures are very different. In 2001, the French insolvency total fell by 6.9 percent on 2000 – there were 2,500 fewer insolvencies. But then last year, the total grew again, by 10.9 percent. Similar trends – a decline in overall insolvencies followed the next year by a rise – were also exhibited by Spain (2001: minus 44.4 percent; 2002: plus 33.7 percent), Finland (2001: minus 4.0 percent; 2002: plus 4.0 percent), Norway (2001: minus 1.0 percent; 2002: plus 20.8 percent), Switzerland (2001: minus 2.5 percent; 2002: plus 2.8 percent) and Austria (2001: minus 1.4 percent; 2002: plus 2.8 percent).

**Tab. 3: Overall insolvency development in Europe 2002 compared with 2001**

■	Insolvencies	Change in Percent
Greece	512	- 13.4
Ireland	379	- 11.2
Luxembourg	695	- 7.3
Belgium	7,121	0.8
Italy	15,600	2.6
Austria	9,023	2.8
Finland	2,904	4.0
Sweden	8,387	4.7
United Kingdom	50,988	5.4
Switzerland	8,802	8.1
Netherlands	6,358	9.0
France	38,688	10.9
Denmark	2,472	12.9
Portugal	1,924	20.7
Norway	4,276	20.8
Spain	448	33.7
Germany	82,400	66.4
<b>Total</b>	<b>240,977</b>	<b>21.7</b>

**Bankruptcy parade**

In the field of business insolvencies, only Greece, Luxembourg and Ireland can point to a decline. In these three countries, the statistics only cover business insolvencies, i.e. overall and business insolvencies correspond.

**2.2 No end in sight:  
Business insolvencies in Germany**

The number of insolvencies in German in 2002 reached a new record level, with 82,400 companies and private individuals going bust. Compared with the 49,510 in 2001, this was a rise of 66.4 %. The number of business bankruptcies was 37,700, 16.4 % up on the 32,390 of the year before. The figure for 2002 includes 24,100 limited companies or ordinary partnerships (2001: 21,250; an increase of 13.4 percent). In Eastern Germany, the business bankruptcy total was 11,100, a climb of 4.3 % on the year before; in Western Germany, the rise was 22.3 percent, from 21,750

in 2001 to 26,600 in 2002. However, by far the biggest proportion of the overall total - around 44,700 in fact – consisted of consumer bankruptcies and “other insolvencies”, the term that covers, for example, the owner-partners of an insolvent company.

***Small firms  
also count***

The damage that insolvencies wrought on companies, private individuals and the public sector in 2002 added up to 38.4 billion euros. The year before, the figure was 32.3 billion euros. Large insolvencies played a considerable role in this 20 % increase. The number of private bad-debt losses per insolvency in Western Germany is stagnating. For creditors in 2002, the average bad-debt loss was 801,000 euros in (2001: 800,000 euros). In Eastern Germany, private debt write-offs per insolvency increased from 432,000 euros in 2001 to 477,000 euros.

A look at business failures in relation to company size as measured in annual sales reveals that in Western Germany, 210 of the companies going broke had sales revenues of over 50 million euros. This was an increase of 53 on the prior year.

Firms are particularly prone to insolvency in the first four years of their existence and then again after ten years. Firms aged ten years and over accounted for 32.5 percent of the insolvency total in Western Germany and for 24.8 percent in the Eastern part of the country. Companies of three or four years in age represent just over 20 percent of the total. Altogether, business bankruptcies in Germany resulted in the loss of 590,000 jobs (2001: 503,000; rise: 17.3 percent).

Particularly in the fields of commerce and construction, consumer reticence but also the lack of any readiness to invest both made themselves clearly felt. The number of wholesale or retail firms making their way to the bankruptcy courts rose by 32.3 percent to 8,800. In all, the services sector accounts for the biggest share of the insolvency total, with 43.2 percent.

The construction sector is especially prone to business failure. The relative risk ratio – the number of insolven-

cies as against the total of firms in the sector – indicates this quite clearly: among builders and contractors, there were 270 bankruptcies for every 10,000 firms. In other sectors, the ratio was well under half that.

All the same, one positive development should be noted: in the past three years, fewer bankruptcy petitions have had to be dismissed for lack of assets. In 2002, the relevant figure in Western Germany was 11,200 (out of a total of around 26,600 applications), corresponding to 42.1 percent. The year before, the proportion was 55 percent. In Eastern Germany, the proportion was 45.9 percent: 5,100 companies as compared with 5,810 in 2001.

### **2.3 National insolvency laws**

Not all European countries make a distinction between business and consumer insolvencies. In many cases, private individuals cannot file for bankruptcy at all. Where they can, the prerequisites and proceedings differ considerably. In Germany, the law in place since 1999 enables private individuals to have themselves declared over-indebted and file a bankruptcy petition. In 2002, there was a veritable flood of such petitions (44,700) following an amendment allowing private individuals to file for insolvency without having to cover the court costs or provide notification of how they intend paying off their creditors. So where private individuals are concerned, there is now no such thing as a case being dismissed for lack of assets; payment of the costs of proceedings is deferred or can even be waived. More and more consumers are now taking advantage of this possibility.

#### ***Consumers: debt remission after 6 years***

In France, over-indebted private individuals have to turn to a special commission whose task it is to reach a settlement between creditors and debtor. Governed by the so-called consumer law, this procedure is applied only to debtors who have acted in good faith and only in connection with private debts.

In England and Wales, private individuals can file for bankruptcy, but as an alternative there is the possibility of meeting with creditors under the supervision of an insolvency specialist and trying to achieve a settlement.

In Italy, only people engaged in commercial activities are capable of going bankrupt; the exceptions are public entities and small traders. Bankruptcy proceedings can be opened against a no longer active business person if he gave up his firm not more than one year previously. The particular feature of Italian bankruptcy law is that unsecured creditors virtually never have their claims satisfied, so obtaining security in respect of outstanding moneys is very important.

In Spain, bankruptcy law is currently undergoing a transformation. At present, debtors who are natural persons can call on their creditors for their debts to be reduced or waived. Any such agreement then has to receive court approval. Bankruptcies by business people and legal entities are regulated by insolvency proceedings. Anyone who withholds due payments is deemed to be in bankruptcy.

In addition to the possibilities offered by the different national insolvency laws to enable private individuals and companies to restructure, there are private initiatives aimed at resuscitating insolvent firms, especially small firms.

The EU is planning to improve its support for financially distressed business people. Up to now there has been little in the way of financing or advisory offers. But business people with a bankruptcy behind them are often more successful in future since they have learned from their mistakes and are thus in a better position to contribute to growth and job creation. Some EU members are taking advantage of this opportunity and supporting companies in their restructuring efforts. This is something other countries can learn from. In the Netherlands, for instance, the “Ondernemersklankbord” provides advice for distressed small and medium-sized companies. Organised as a

### ***Support from the EU***

foundation, it consists of retired experienced former executives and entrepreneurs who operate on a voluntary basis. In Utrecht, the regional court consults with these business veterans on whether a financially troubled firm can be saved. And eight out of ten candidates for bankruptcy actually are rescued in this way. The project is now to be extended to other regional courts.

In Austria, help is made available to unsecured creditors. SMEs can draw on the help of creditor protection associations if they face the prospect of losses when a debtor becomes insolvent. Moreover, Austrian insolvency law obliges bankruptcy administrators to gear their efforts primarily to rescue rather than liquidation.

In France, some entrepreneurs and executives have got together under the name “Re-cr  er” with the aim of supporting business people in crisis situations. They also seek to have the relevant laws improved and to change public attitudes about bankruptcies.

In Germany, Crisme (Crisis Intervention in Small Enterprises) helps distressed SMEs by providing consultancy for a low fee.

The first moves towards unified insolvency legislation at the EU level have been in force since May 2002: the relevant EC directive for the first time creates a uniform international insolvency law within the European community (with the exception of Denmark). It regulates the scope of authority for insolvency proceedings and lays down which national law is to be applied, including the international effects of the individual legal transactions involved. In particular, it states that as a matter of principle, the opening of an insolvency case in any member country must be recognised by all the other EU members.

***Insolvency decree in place since May 2002***

## **2.4 Big corporate insolvencies**

The observation that Germany is the tail-ender in terms of economic growth but right up in front when it comes to bankruptcies is true at least in respect of the

biggest insolvencies in 2002. There are seven German companies among the European top ten.

In first place comes **Philipp Holzmann**, the huge bankruptcy in the construction sector which in the meantime has taken a good many smaller firms with it into the abyss. Then there is the collapse of the mechanical engineering group **Babcock Borsig**, which employed 22,000 people worldwide. In April 2002, Leo Kirch filed an application for insolvency for his media company **KirchMedia**, and the proceedings were opened in June. By now it is virtually certain that the Hamburg publishers Heinrich Bauer will acquire KirchMedia, including the TV stations Pro Sieben and Sat 1.

***Germany: Seven of ten  
biggest bankruptcies***

The bursting of the stock market bubble is almost certainly one of the reasons for the greater incidence of business demise in the financial sector. The Frankfurt bank **Gontard & Metallbank** was the biggest financial institution to go bankrupt in 2002, and takes fourth place in the European rankings.

**Albert Fisher**, a wholesale company specialising in the sale of food, beverages and tobacco, was the biggest bankruptcy of 2002 in the United Kingdom. It is followed in sixth place by another German company: at the end of May last year, automotive supplier **Peguform** had to file for insolvency. In October, proceedings were opened, and the company, based in Bötzingen, was placed in the hands of the renowned insolvency administrator Jobst Wellensiek.

In seventh place comes the French IT company **Metrologie**, an office equipment wholesaler. The judicial restructuring proceedings opened on January 31, 2002.

In May, the Dutch Internet operator **KPNQuest** had to file for bankruptcy. In the previous two years, the company, jointly owned by KPN of the Netherlands and Qwest, the US telecoms group, had run up debts of 1.8 billion euros and then found itself unable to pay back the interest on this. The two main shareholders

have stated that they are not prepared to inject additional funds.

**Fairchild Dornier**, the aviation company from Oberpfaffenhofen in Bavaria, was forced into bankruptcy after failing to find a strategic partner. And then around Easter, there was building materials trader **Mühl** from Thuringia. This bankruptcy affected some 3,500 employees.

The second big Dutch company to go bankrupt last year was **Landis ICT**, a Utrecht-based wholesaler dealing in automation products (primarily network products). Spain's biggest insolvency was **Garcia Munte Petroleos**, the country's biggest oil trader, went bust. Positions 13 and 14 in the European list are occupied by British companies: **OT Computer** and steel firm **ASW**. Taking 15<sup>th</sup> place is **LIBRO AG**, the Austrian media products vendor. Its collapse became inevitable after the failure of restructuring efforts by a banking consortium.

**Tab. 4: The 15 biggest insolvencies in Europe in 2002**

■	Sector	Country	Sales in mio. euros
Philipp Holzmann	Construction	D	6,400
Babcock Borsig	Mech. engineering	D	5,113
KirchMedia	Media	D	3,300
Gontard & Metallbank	Bank	GB	1,700
Albert Fisher	Wholesaler	D	1,164
Peguform	Auto. supplier	D	900
Metrologie	IT	F	824
KPNQ West	Telecoms	NL	810
Mühl	Wholesaler	D	700
Fairchild Dornier	Aerospace	D	700
Landis ICT	IT	NL	667
Garcia Munte Petroleos	Oil	E	572
OT Computer	IT	GB	555
ASW	Steel	GB	421
Libro	Publisher	A	325

### ■ 3 Structures of SMEs in Europe – The economic background to insolvencies

The year 2002 was more marked by large-scale insolvencies than any year before. Nonetheless, the companies most affected by insolvency are the SMEs who dominate the business scene in all Western European countries. With the euphoria over all the global mergers and corporate acquisitions around the turn of the millennium now dying down, the company landscape has not changed much.

Of the 20 million business firms in Western Europe, only 0.3 percent have more than 250 employees. Around 95 million people earn their living in small and medium-sized enterprises. But a closer look is needed. Firms of the size generally regarded in Germany as forming the “Mittelstand”, i.e. those with between 50 and 249 employees, represent just 1.5 percent of all business companies. The designation “small firms” is usually applied to those with a workforce of between 10 and 49. These represent 9.1 percent of the total. The vast majority, 89.1 percent, of all European firms are “micro-enterprises” with nine or fewer employees. When it comes to sales revenues, firms in the Mittelstand still have a two-thirds majority compared with big companies of over 250 employees (in the USA, on the other hand, large companies employ 50 percent of all those in gainful employment and generate almost 60 percent of turnover).

The extent to which SMEs dominate the business scene, and what structures such firms have, is highlighted by two further figures. A current EU analysis points out that the average firm has six employees. But it must be remembered that micro-enterprises have on average just two employees (in fact about half of all these businesses do not have any employees at all, they are self-employed persons earning a living for themselves and their families). Among micro-enterprises, the average turnover is around 200,000 euros a year. Unfortunately, only very few national statistics offices specify the proportions of the insolvency total made up by the different size categories.

***More self-employed  
than people with businesses***

Taking the figures available for Germany, it becomes evident that it is the micro-enterprises which are most insolvency-prone.

In Germany in 2002, almost two-thirds (63.9 percent) of the businesses that went broke employed at the most five people. Just 1.6 percent of the bankruptcy petitions in Germany were filed by companies with more than 100 employees. If further differentiation is carried out in accordance with the EU size threshold (250 employees) or the German size definition (up to 500 employees), such firms would be in the per thousand range.

**Tab. 5: Number of people employed by companies in Germany declaring bankruptcy (sector average)**

■	West	East	Germany
1 – 5 people	64.5 (60.4)	62.0 (48.3)	63.9 (57.0)
6 – 10 people	13.6 (15.8)	16.0 (18.8)	14.2 (16.6)
11 – 20 people	10.1 (11.2)	11.6 (17.1)	10.5 (12.7)
21 – 50 people	7.3 ( 8.1)	7.8 (11.5)	7.4 ( 9.1)
51 – 100 people	2.7 ( 2.8)	1.9 ( 3.0)	2.5 ( 2.9)
> 100 people	1.9 ( 1.8)	0.8 ( 1.3)	1.6 ( 1.8)

Figures in percent; ( ) = prior year figures

### ***Fewer large companies in Southern Europe***

The 2000 Eurostat database on SMEs nevertheless still describes Germany as a country dominated by big companies. The decisive reason for this statement is that here large companies have the biggest proportion of the total workforce. By the same terms, such countries as Finland, Sweden and the United Kingdom are also big company-dominated. On average, German firms employ eight people. That puts this country above the Western European average, together with Austria, Ireland, Luxembourg (ten employees), Denmark (nine), Sweden (eight) and France (seven).

A total of 590,000 people in Germany were affected in 2002 when their employers went bust. This indicates that firms filing an application for bankruptcy are above average in size. In fact, taking all business failures into account, the average workforce of German firms be-

coming insolvent is 15. The figure for Western Europe as a whole is just under eleven.

Altogether in 2002, insolvency threatened around 1.6 million people in Europe with unemployment. This is 200,000 people than the year before (a rise of 14.3 percent). It represents an average of over eleven people per bankrupt firm.

**Tab. 6: Insolvency-related unemployment in Europe**

■	Number of jobs lost (in millions)
1997	1.8
1998	1.6
1999	1.4
2000	1.1
2001	1.4
2002	1.6

**1.6 million jobs lost**

In fact, though, this average is lower. To get the complete picture, we need to look beyond the more than 150,000 business insolvencies. A considerable proportion of the overall insolvency total needs to be taken into account into connection with job losses, since in many cases these other insolvencies are not purely consumer bankruptcies but were preceded by some kind of business activity. So, taking the overall insolvency total of 240,000 in Western Europe as a basis, a more realistic figure for the average number of people affected in each case is 6.6.

One other factor is that in some countries, micro-enterprises cannot file for bankruptcy. This explains for example why Greece and Spain report such a low number of insolvencies (512 and 448 respectively) despite the fact that both these Southern European countries are dominated by micro-enterprises. Spanish businesses have an average of five employees, the figure in Greece is two. Something else to be taken into account is that in Germany, for instance, the term “private bankruptcies” also covers former business people using this option to relieve their situation.

When examining what specific factors make SMEs in Europe prone to failure, we should take a look at what particular difficulties firms in this size range face and at their various dependencies.

### ***Survival comes first***

When asked about the chief aims of their business strategy, micro-enterprises in particular put the “struggle for survival” in equal first place with the goal of growth. 21 percent of such firms see sheer survival as more important than stepping up profits or introducing innovations – which in itself is a pointer to business instability. Micro-enterprises in general form the most insolvency-prone business size category and there is no doubt that this one-fifth of the firms in this range also suffer from falling employee totals. That is yet another indication that the number of insolvency-related job losses is actually higher than the 1.6 million mentioned above: in their fight for existence, firms have already dismissed employees before they finally collapse. Somewhat paradoxically, micro-enterprises also complain that one of the chief things holding back their business progress (alongside the difficulty of raising finance, to be discussed below) is the shortage of skilled employees.

Something else that affects the survival of SMEs in Europe is the extent of their competition with large companies (LCs). In the past few years in particular, SMEs have fallen behind LCs in respect of business performance. They have lower growth and productivity rates. On the other hand, a close business relationship with a large company or companies can be an aid to survival for small firms. Almost one-third of SMEs in Sweden generate over 50 percent of their sales through such relationships. At the other end of the scale are Greek firms; they tend to cooperate mainly with other enterprises in their own size category (89 percent; only eleven percent with LCs). Countries where SMEs exhibit greater dependence on large companies are often also countries where the rise in insolvency volumes is lower: Sweden (up by just 5.2 percent), Belgium (0.8 percent) and Italy (2.6 percent). One exception here is Finland: also high dependence on LCs but insolvency up by 34.9 percent. On the

other hand, Countries where SMEs tend not to have such close business relationships with large companies generally exhibit growing insolvency totals: Spain (insolvencies up by 30.7 percent), Germany (16.4 percent), Denmark (12.9 percent) and Switzerland (32.9 percent). Here the exception is Greece: insolvencies down by 13.4 percent.

**Tab. 7: SMEs generating over 50 percent of sales with their three biggest customers compared with the change in business insolvency totals**

■	Over 50% sales with 3 large customers	Change in insolvency (2001 to 2002)
Sweden	31	+ 5.2
Belgium	25	+ 0.8
Italy	24	+ 2.6
Finland	24	+ 34.9
UK	23	+ 7.6
Austria	22	+ 1.5
France	21	+ 10.9
Netherlands	21	+ 10.9
Portugal	21	+ 20.7
Norway	21	+ 15.3
Ireland	21	- 11.2
Spain	20	+ 33.7
Germany	20	+ 16.4
Luxembourg	16	- 7.3
Denmark	16	+ 12.9
Switzerland	13	+ 32.9
Greece	11	- 13.4

***Strong partners  
create stability***

Figures in percentage  
Source: Grant Thornton

Structurally, SMEs in Europe are inferior to larger companies and they are also less favoured by the economy. In the past few years, economic growth in Europe has been chiefly export-driven. This applies both to the European Union as a whole and also to the individual member countries with their different varying import and export ratios. The general economic downturn began as early as 2001, but this was not really reflected by the growth in insolvencies that year – they rose by just 5.9 percent. This was because

***SMEs cut off from  
growth through exports***

business failures generally occur only after a certain time lag. At the beginning of 2002, it was the export sector that seemed to be recovering fastest. But this proved a flash in the pan: the entire Eurozone in fact expanded its exports of goods and services by just 0.7 percent, significantly under the prior-year level of 2.6 percent. Since SMEs mainly operate only locally, they do not benefit from any export-driven surge in economic activity. A survey of micro-enterprises revealed that just seven percent export goods or services, and even then the transactions normally involve partners just beyond the nearest border. So export-related problems affect such tiny firms only indirectly, for example if they are dependent on an export-oriented large company. "The smaller the firm, the smaller on the whole is its geographical market area", says the EU.

In Germany, and the other Western European countries as well, it is primarily the weak level of domestic activity which is causing problems for smaller firms and fuelling the high growth in the field of insolvencies. Private consumption in Germany has in fact already been weakening for some years, but in other countries on the European continent it has up to now proved robust. That picture changed in 2002. Private consumer expenditure grew by just 0.7 percent. Consumer confidence, measured by the responses of ordinary citizens to questions regarding their purchases, the economic situation and their own household situation, sagged markedly in the autumn of 2001 and remained negative throughout 2002.

Nor did business people – in the face of high free capacities and lower utilisation levels – see any reason to invest. Investment in plant and equipment fell by four percent. Germany was at the bottom of the field in respect of capital expenditure: in 2002, the Creditreform autumn survey of SMEs showed readiness to invest at a very low point. The sectors most heavily hit by such economic developments have been construction and service-providers. The construction sector's share of the insolvency total in Europe rose within the course of the year from 20.4 to 21.4 percent. In the field of serv-

ices, the increase was even greater: from 37.8 percent (2001) to 40.6 percent (2002). Manufacturing and – surprisingly enough – commerce managed to master the crisis better. The construction business is dominated by small firms, and just how susceptible it is to insolvency, not only in Germany but in Europe as a whole, is shown by the fact that while builders represent only 13 percent of the total number of business companies in the EU (2.75 million companies), they account for over a fifth of all bankruptcies.

**Tab. 8: Insolvencies in the main branches of the economy in Europe in 2002**

■	Share of total volume
Manufacturing	12.4 (13.8)
Construction	21.4 (20.4)
Commerce	25.6 (28.0)
Services	40.6 (37.8)

Figures in percent, ( ) = 2001

Firms which provide services divide into two categories: credit and insurance businesses, largely dominated by large companies, and firms in the property field, or cleaning firms, business consultants, advertising agencies and the like which cater for the needs of large companies. The first of these two categories, despite the structural problems they currently have to deal with, remained relatively stable, but the generally smaller firms in the second category were hit by the streamlining measures undertaken by their customers and the reticence on the part of such companies to invest. The greater volume of insolvencies in the field of services was, though, fuelled above all by the collapse of firms providing consumer-related services. They were even more affected by consumer reticence than wholesalers and retailers.

***Builders and service-providers most affected***

Not all countries provide detailed information on the insolvency proportions of the various branches of the economy. In those that do, major differences are evident. In the United Kingdom and Spain, for instance, the manufacturing sector suffered most; in Denmark, the Netherlands, Germany and Norway, service-

providers accounted for big shares of the total. In both Germany and the United Kingdom the construction sector fared badly, with 23.1 and 23.6 percent respectively of the insolvency volumes.

**Tab. 9: Insolvencies in the main branches of the economy in 2002**

■	Manufac- turing	Construc- tion	Com- merce *	Services.
Belgium	9.9	18.5	41.4	30.2
Denmark	9.2	10.8	19.4	60.5
France	12.7	21.7	26.3	39.3
Germany	10.5	23.1	23.2	43.2
Netherlands	13.6	14.3	26.9	45.3
Norway	11.2	10.4	35.5	43.0
Spain	36.0	18.0	14.0	32.0
UK	30.0	23.6	19.6	26.8

\*) including catering, figures in percent

### ***SMEs: opportunities and risks***

Greater flexibility in adapting products and services to changed economic and structural conditions can help SMEs to win through. Economic downturns may hit such businesses only after a certain time lag, but – as the course of insolvencies in the past two years has shown – when they do, it is with great severity. The record number of insolvencies also indicates how difficult it is, in the face of competition from large companies in Western Europe, for the Mittelstand in general to survive.

#### **■ 4 The financing bottleneck: The stability of SMEs in Europe**

The growing number of business insolvencies in Europe is closely related to the problem of adequate financing and in particular to the fact that many firms have a poor level of own resources. If a company's equity ratio (the ratio between own capital and the balance-sheet total) is too low, its business stability is endangered: in times of crisis, it has no resources to draw on in order, for example, to offset current losses.

The equity ratio of SMEs in Europe varies considerably. It depends essentially on a country's specific financing situation. The decisive factors are the type of tax system, the structure of the banking sector and a country's general financing traditions.

***Self-financing must be strengthened***

French, Belgian and Dutch firms generally have relatively high equity ratios; in Austria and above all in Germany, the level of capitalisation is chronically weak. In France, smaller companies with annual sales of up to 50 million euros have on average an equity ratio of 34 percent, in Germany, the figure is 18 percent. And this is reflected in the development of insolvencies. Since 1997, both France and Belgium have seen their totals fall, while Austria and Germany have registered substantial increases.

**Tab. 10: International comparison of balance-sheet ratios among SMEs**

■	Smaller companies (annual sales up to 50 million euros)				
	D	F	I	NL	USA
Equity	18.0	33.9	22.4	34.6	44.9
Reserves	13.5	2.8	6.7	12.0	2.3
Outside finance	68.5	63.3	70.9	53.4	52.8
- of this: banks	24.1	12.6	25.8	15.6	20.4
■	Large companies (annual sales above 50 million euros)				
	D	F	I	NL	USA
Equity	30.1	35.2	26.7	48.8	37.4
Reserves	29.8	6.0	8.7	4.9	15.5
Outside finance	39.9	58.8	64.6	46.3	47.1
- of this: banks	6.7	7.5	19.0	8.4	9.0

Figures in percentage of balance-sheet total  
Sources: Creditreform, Deutsche Bundesbank, BACH-Datenbank

They are several reasons why German SMEs have such low equity ratio by European standards. Up to now, the tax system in Germany has favoured borrowing because the interest payments could be set against tax. Another factor: in Germany, taxation depends on a company's specific legal form, and this has discriminated against SMEs as compared with limited companies and made profit retention more difficult for them. The vast majority of the firms that make up the

***The influence of the tax system***

German Mittelstand are sole traders or partnerships, and they are subject to income tax and trade tax. The top rate of income tax in Germany, including the so-called “solidarity surcharge”, is 51.2 percent, the sixth-highest rate among the 17 important industrial countries, while the tax rate for limited companies is a uniform 25 percent.

Because of their increasingly scanty level of own resources, German SMEs have become more and more dependent on credit. When it comes to obtaining finance, the decisive factor for any SME is its relationship with its “house bank“. And here, things have changed in the past months. Margins at banks have deteriorated, the scale of their insolvency-related losses has increased, and together with the new capital adequacy requirements of Basel II, this has made it more and more difficult for SMEs to obtain bank loans. The amount of money being lent by the banks is on the decline.

Alternative forms of capitalisation, such as equity financing by going public, seem to represent an attractive option only for larger companies, since they involve high costs. The steep drop in share prices and the general loss of confidence in stock markets has resulted in a significant fall in the number of IPOs in Europe since mid-2000 – it is back to the low level of the mid-90s, of just over 15 new listings a year. And anyway, only few SMEs are prepared to give others a say in their business affairs or to disclose their business data.

One important cause of the rise in business insolvencies not only in Germany but throughout the Eurozone is the weaker level of lending. The growth rate in book loans to the private sector in the Eurozone is on a downward path; the most recent figure (November 2002) was just 4.5 percent, with the trend being fuelled in particular by the decline in lending in Germany. The volume of credit granted to the self-employed and business companies in Germany fell in real terms for the first time since the recession of the mid-70s. Ac-

***More difficult to obtain  
outside capital***

According to the KfW (Reconstruction Loan Corporation), there was a fall last year of 2.4 percent on 2001.

In addition to the duller economic climate, this is due to the more restrictive lending practices adopted by the banks, especially by the big commercial banks. The collapse in share prices and the many business insolvencies have made banks much more wary than they were before.

And the banks feel they have to offset the losses they have made in investment business by imposing more expensive credit terms. The German Bundesbank has noted that the commercial banks in Germany passed on the lower ECB interest rates to their customers only very hesitantly. Since last spring, the ECB has reduced its key interest rates by two percentage points, but the terms governing short-term company loans have been cut by only a quarter of that. Another factor is that smaller business loans are not profitable for banks, because the costs involved are the same as for much bigger credit lines.

The decline in credit growth in Europe and the actual fall in lending in Germany create an unsatisfactory situation, because they cut off SMEs – with their anyway poor level of capitalisation – from participating in any economic upturn since they lack the financial resources for necessary investments. In the first phase of a boom this can then force such firms into bankruptcy.

Banks associate lending to SMEs with a substantial risk of default. Those small and medium-sized companies which do obtain loans despite this often do not get the credit line they actually wanted, since the information deficit caused by a lack of internal rating means that banks cannot assess the business risks involved appropriately.

***Lack of  
risk-awareness***

But SMEs themselves must bear their share of the blame. They have too few instruments for financial controlling. A study by Marsh on risk management among European SMEs confirms this. It shows that

while German SMEs are among the more risk-aware firms, they are only European average when it comes to actually guarding against risks. Only 34 percent of companies have their risk management systems checked regularly. And just nine percent of the German firms surveyed are fully aware that this is a field in which they can lose money. Generally speaking, firms in the Northern European countries are more aware of risks than those in Southern Europe. The problem with poor risk management is that companies often only discover their weak points when it is too late and so they are more prone to insolvency.

### ***Ways out of the “liquidity trap”***

One alternative to obtaining a bank loan is securitisation, i.e. converting accounts receivable and assets into tradable paper. Companies which can point to a stable development on the revenues front sell their asset items to specialised companies that use these to issue bonds. This enables such firms to obtain a sizeable amount of cash at an early stage on the basis of their future revenues. According to rating agency Moody's, the market for securitisation in the long-term segment in Germany grew last year from 14 to 35 billion euros. This puts Germany in third place in Europe after the United Kingdom and Italy. For smaller companies, a more appropriate financing instrument is factoring.

The European Commission has already reacted to the financing bottlenecks and is offering programmes geared to smaller firms and administered by the European Investment Fund (EIF). This operates not directly but via financial brokers in the individual member countries who then provide support for SMEs, in the form of investment or guarantees, through national credit programmes or venture capital funds. But here, once again, an information deficit on both sides makes the granting of credit more difficult.

### ***Poor payment morale***

One serious liquidity problem confronting European SMEs – in fact one of the main reasons for insolvencies – is poor payment conduct of the part of many of their customers. According to the rating agency Standard and Poor's, the number and volume of payment

defaults among business companies reached new record levels in 2002. Worldwide, some 234 large companies, owing a total of 177.8 billion dollars, were unable to service their debts. The year before the figures were 220 companies and a total debt volume of 118.8 billion dollars.

An examination of payment conduct in Europe shows that particularly companies in Italy, France and Belgium, where payment periods are between 39 and 66 days, can take a lot of time before settling invoices. If the average delay in payment is added, it can be up to almost three months before suppliers in Italy actually see a payment credited to their accounts. At the same time, these countries exhibit a very high number of business insolvencies.

**Tab. 11: Payment conduct in Europe in days**

■	Payment terms	Payment delay	Total
Italy	66 (64)	21 (24)	87 (88)
France	46 (45)	10 (12)	56 (57)
Belgium	39 (41)	22 (20)	61 (61)
UK	31 (29)	23 (28)	54 (57)
Austria	27 (25)	10 (13)	37 (38)
Switzerland	22 (24)	14 (16)	36 (40)
Netherlands	26 (26)	20 (21)	46 (47)
Germany	23 (23)	17 (18)	40 (41)
Sweden	26 (24)	8 ( 9)	34 (33)

( ) = 2001

Such poor payment morale shows how necessary it was for the European directive on delayed payments to be transposed into national law last year: all EU members were required to impose the stricter European ruling by August 2002. The directive stipulates that interest on the arrears should be seven percentage points above the key ECB refinancing rate, instead of the 3.5 percent previously in force. Another way in which the new directive is more friendly to creditors is that in future, a payment is regarded as overdue automatically 30 days after receipt of the invoice or receipt of the goods supplied or after the end of the agreed payment period.

But all the same, the directive does not go far enough. It applies only to business transactions between companies and between companies and public authorities. It does not cover sales agreements with private individuals or contracts for work and services. Anyway, firms with good customers who pay late but nonetheless do always pay in the end are hardly likely to offend these customers by actually claiming the high interest payments on arrears. And if the amounts involved are only small, the administrative input required could simply be too high. After all, many companies not only ignore payment reminders, they also ignore claims for interest on arrears. So the new law has not yet done much to improve payment morale. For it to do so, the rules regarding enforcement need to be amended to enable creditors to get their money more quickly.

***SMEs profit too little  
from exports***

The combination of inadequate equity ratio and deferred payments or payment defaults can lead straight to insolvency. Generally, this is preceded by lower sales revenues and earnings.

A European Commission study has shown that in the period 1988-2001, annual sales growth in real terms among European companies was governed by the level of exports. Since large companies are better represented in foreign markets and small companies in domestic markets, the large companies post greater growth in sales and production than smaller firms. The proportion that exports contribute to the sales of even Europe's bigger SMEs is just 13 percent. The figure for large companies is 21 percent.

The same European Commission study has shown that in many countries SMEs exhibit lower profitability (regarded as the difference between real value added and labour costs as a percentage of value added) than large companies. According to estimates by EIM Business Policy and Research, European SMEs in 2000 had an average profitability of 14 percent, compared with over 50 percent for large companies.

**Portugal and Ireland at the top**

An analysis by country shows that small and medium-sized enterprises in Portugal, Ireland and Italy had the biggest positive average annual rate of change in profitability, presumably because of lower labour costs and EU transfer funds. Such EU net contributors and high-tax countries like Germany and Finland are in the lower mid-range in this respect.

**Tab. 12: Real value added, employment and profitability in European countries 1988-2001**

■	Real value added		Employment		Profitability *)	
	SME	LC	SME	LC	SME	LC
Belgium	1.9	2.2	0.2	0.0	0.1	0.4
France	1.3	2.4	0.3	0.7	- 0.1	0.2
Germany	2.5	3.2	0.3	- 0.3	0.3	0.6
Greece	3.3	2.3	2.1	1.0	- 0.6	- 3.0
Ireland	7.7	9.5	2.8	3.1	2.1	0.9
Netherlands	2.1	2.5	1.1	0.9	0.0	0.3
Portugal	3.0	3.3	0.2	0.4	2.6	0.7
Spain	2.7	2.9	1.2	1.3	0.4	0.4

Average annual change in %

\*) Difference between value added and labour costs, corrected in line with the imputed entrepreneurial profit

Sources: Estimate by EIM Business & Policy Research; the estimates are based on the Eurostat SME database, Source: Europäische Wirtschaft, Beiheft A, June 2001; OECD, Wirtschaftsausblick Nr. 69, June 2001

Throughout Europe, financing is the Achilles' heel of SMEs. The combination of low equity ratio, greater difficulties in raising outside capital, liquidity bottlenecks and lower profits can lead straight to insolvency. But the way insolvency totals evolve is also affected by other factors, such as the economic cycle, or a country's monetary or economic policy. To ensure a sustained fall in the volume of insolvencies, the conditions governing all these factors must be improved.

**■ 5 Insolvencies in the USA and Japan**

It is not just Europe which is suffering from an insolvency wave. In 2002, both Japan and the USA posted new insolvency records. In Japan, 19,750 companies were forced to make their way to the bankruptcy courts, an increase of 4.7 percent on the prior year.

The total volume of debt default in the first half of 2002 was 7.4 trillion yen (57.5 billion euros), a rise of 3.2 percent. Of this, all of 449.9 billion yen (3.5 billion euros) resulted from Japan's most spectacular bankruptcy of the year: in March, construction giant **Sato Kogyo Co. Ltd.** was forced to file for bankruptcy. Since the speculative bubble burst at the beginning of the 90s, Japan's companies have been feeling the impact of high borrowings from bank. This situation has been intensified by the current deflationary tendencies in the Japanese economy, with prices and profits falling and losses moving upwards. According to the central bank, the Bank of Japan (BOJ), demand for bank loans from commercial banks has dropped steadily since the mid-90s.

### ***Accepting insolvencies***

Nevertheless, the BOJ sees the recession as coming to an end. It says that although both private consumption and business investment are on a downward trajectory, the increasing demand in international markets is boosting Japanese exports and industrial production. Within the foreseeable future, this could lead to an improvement in the economic situation. But this does not alter the fact that the accounts of Japanese banks still contain large numbers of poorly secured loans where repayment is uncertain. A shake-out is essential, but also generates risks.

In the USA, the overall number of insolvencies in 2002 was 1,574,672. But this huge total was fuelled mainly by consumer insolvencies. 1,536,135 private individuals filed for bankruptcy last year, an increase of 5.8 percent on 2001 (1,452,030). The number of business bankruptcies actually fell: in 2001 the figure was 40,099, last year it was around 38,537 – a decline of 3.9 percent. All the same, as in Germany, spectacular collapses by big companies grabbed the headlines. The insolvency of self-service retail chain **Kmart** in January was just the beginning. Then came airlines and telecoms. In August, one major victim was the country's sixth-biggest airline **US Airways**; in December it was followed by the second-biggest, **United Airlines**. Then there was **Global Crossing**, which had

run up huge debts following the rapid expansion of a worldwide telecommunications network.

Some of the big collapses were brought about by mis-judged investment or weaker levels of business, but what really made 2002 stand out was the extent of corporate fraud and deceit. **Enron**, America’s biggest energy trader, went broke when it became apparent that the company had established a complicated network of off-balance-sheet partnerships which existed purely to offload debt from its financial statements. Before investors had recovered from this shock, they were confronted by another dismal piece of news: in June, telecoms giant **Worldcom** applied for bankruptcy after confessing to false balance-sheet entries to the tune of billions. This level of duplicity led to a massive loss of confidence on Wall Street and brought about the passing of the Sarbanes-Oxley Act, which requires annual financial statements to be signed off by CEOs and set up a new regulatory authority for auditors.

**Loss of confidence**

**Tab. 13: The 10 biggest insolvencies in the USA in 2002**

■	Sector	Sales in billion dollars
Worldcom	Telecoms	37.1
K-Mart	Retailing	37.0
United Airlines	Airline	14.2
US Airways	Airline	10.1
Farmland Ind.	Food production	4.9
NTL Group	Telecommunications	4.6
Kaiser Aluminium	Aluminium	3.8
Adelphia	Telecoms	3.5
National Steel	Steel	2.4
Cellstar	IT	2.4

Contrary to the situation which still obtains in Germany, filing a petition for insolvency in the USA does not say anything about whether or not a company will survive. This is because American firms can apply for protection under Chapter 11. This shields them for a while from the claims of their creditors and thus gives them enough time to get their finances in order and initiate

**Chapter 11  
subject of controversy**

restructuring measures. In 2002, 11,293 American companies took advantage of this possibility. Critics complain that this option is too corporation-oriented and distorts market conditions by enabling firms which are essentially bankrupt to survive as “zombies” and drive other, healthier companies out of business. On the other hand, though, there is no denying that Chapter 11 has produced successes. Continental, for example, developed into a profitable company while under the protection of Chapter 11.

Americans do not have the problems created by insolvency legislation in many European countries: that companies are either liquidated too quickly or kept artificially alive by means of state aid outside the bounds of insolvency law.

However, it is at least doubtful whether the American system in its entirety can serve as a model for other countries. One example that suggests the opposite is Harvard Industries, a company which has now filed for protection under Chapter 11 for the fourth time, or should we say it is under the protection of Chapter 44?

## ■ 6 Summary

Insolvency figures in Europe in 2002 were significantly higher than in the previous year. The overall number of insolvencies (including bankruptcies by private individuals) reached 240,977. Compared with 2001, this represents growth of 21.7 percent (2001: 198,031). Only three of the 17 countries covered by this survey (EU plus Norway and Switzerland) posted a lower insolvency total: Greece with a fall of 13.4 percent (2001: 591 insolvencies; 2002: 512), Ireland with a drop of 11.2 percent from 427 to 379, and Luxembourg with a decline from 750 in 2001 to 695 last year.

Germany registered the strongest growth in the overall number of insolvencies. 32,890 more companies and private individuals were forced into the bankruptcy courts than in 2001, corresponding to a climb of 66.4 percent. The second-biggest increase came in Spain, although there – because of the legal framework – the

absolute figures are in fact very low: in 2001 there were 335 insolvencies, in 2002, 448, a rise of 33.7 percent.

This was the third year in succession that the aggregate number of insolvencies in Europe has risen. Since 1999, the volume has increased from 184,150 (1999) to almost 241,000 at present.

Business insolvencies in Europe in 2002 totalled 150,275, a rise of 10.7 percent: there were almost 15,000 more company collapses than in 2001, when the figure was 135,792. The highest increases were recorded by Finland (up 34.9 percent to 2,802), closely followed by Spain (plus 33.7 percent) and Switzerland (plus 32.9 percent to 4,800 in 2002). Lower figures came from Greece (down 13.4 percent), Ireland (down 11.2 percent to 379) and Luxembourg, with a fall of 7.3 percent.

The list of Europe's biggest corporate insolvencies in 2002 was dominated by German firms. Germany accounts for seven of the top ten. Heading the list is Philipp Holzmann, followed by Babcock Borsig, KirchMedia, and Gontard & Metallbank of Frankfurt. The first non-German company comes in fifth place: Albert Fisher of the United Kingdom. It is followed by German automotive supplier Peguform. In seventh place comes France's biggest bankruptcy: IT company Metrologie. Next is KPNQwest of the Netherlands, followed in ninth and tenth places by two more German companies: Fairchild Dornier of Oberpfaffenhofen and construction materials wholesaler Mühl, Thuringia.

Even though 2002 saw the demise of more large companies and corporate groups than ever before, it is small and medium-sized firms which are chiefly affected by insolvency. In Germany, almost two-thirds (63.9 percent) of firms going bankrupt employ at the most five people. Only 1.6 percent of all insolvency applications come from companies with more than 100 people on their payrolls. But after all, only 0.3 percent of the 20 million or so business companies in Western Europe have more than 250 employees.

The increased number of insolvencies in 2002 impacted on the European labour market, bringing the threat of unemployment to 1.6 million people working for firms that went bankrupt. The figure in 2001 was 1.4 million.

The chief economic reason for the rise in insolvencies is the weak level of demand in the domestic market. Unlike large companies, SMEs operate mainly locally. Private consumption, which in Germany has been in decline for some time, is now more sluggish throughout the Eurozone – last year it grew by just 0.7 per cent.

The sectors particularly affected by the duller economic climate are those dominated by SMEs: service firms and building contractors. The proportion contributed to the European insolvency total by the construction sector rose from 20.4 to 21.4 per cent. The relative growth of bankruptcies among service firms was even more marked: it was up from 37.8 to 40.6 per cent in 2002. Overall, though, the situation in the European construction sector is more dramatic: it represents just 13 per cent of all business companies but accounted more than one-fifth of all insolvencies.

The sector most affected by bankruptcies varied between the individual European countries. In the United Kingdom and Spain, manufacturing fared worst. In Denmark, Norway, Germany and the Netherlands, the insolvency scene was dominated by service firms.

SMEs in particular often have only a thin equity base. In Germany, SMEs with sales under 50 million euros a year have an equity ratio of just 18 per cent. The figure in France, 34 per cent, is much more substantial.

One difficulty facing small and medium-sized companies in Europe is the lower level of bank lending. The growth rate in current account loans to the private sector is declining: the most recent figure (November 2002) was just 4.5 per cent, with Germany – where lending has been down since 2001 – making a particularly marked contribution to the weak development of credit in the Eurozone. The European Commission

has already reacted to these financing bottlenecks and is offering special programmes geared especially to smaller firms.

In addition to more restrictive lending policies on the part of banks, SMEs have to face slower payment by their customers. This is particularly the case in Italy, France and Belgium. In Italy, invoices are settled only after 87 days on average, in Belgium the figure is 61 days and in France 56.

Financing remains the Achilles' heel of small and medium-sized firms in Europe. The combination of a low equity ratio, increased difficulty in obtaining outside funding, liquidity bottlenecks and lower profits often leads straight to insolvency. Then of course there is the sluggish economy and an unfavourable fiscal and economic policy.

Both Japan and the USA posted new insolvency records in 2002. In Japan, 19,750 companies had to file for bankruptcy, an increase of 4.7 percent on 2001. In the USA, insolvencies now total over 1.5 million. However, this high figure is fuelled mainly by consumer bankruptcies. Only 38,537 companies became insolvent in 2002. And that is just slightly higher than the figure for Germany.

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### German Chambers of Commerce

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Centro Studi Confindustria, Rome  
Creditinform, Oslo  
Creditreform Österreich, Vienna  
Creditreform Schweiz, St. Gallen  
EuroCommerce, Brussels  
FEBIS Federation of Business Information Services, Amsterdam  
FINSKA Suomen Asiakastieto Oy, Helsinki  
Gerling Namur, Namur  
Graydon Belgium N.V., Antwerpen

Graydon NL, Amsterdam  
Graydon UK  
ICAP, Greece  
Intrum Justitia BV, Amsterdam  
Experian Ireland Ltd., Dublin  
Koebmandstanden, Copenhagen  
KSV Kreditschutzverband von 1870, Vienna  
Marsh, Munich  
Moody's, Frankfurt/Main  
OR Telematique, Paris  
SCRL Observatoire des Entreprise  
Society of Practitioners of Insolvency  
Standard and Poor's, Frankfurt/Main  
UC AB, Stockholm

### **Economic information services**

Banco Bilbao v. Vizcaya, Spain  
Banque Nationale de Belgique NBB, Brussels  
BDI, Bundesverband der deutschen Industrie, Cologne  
BfAi Bundesstelle für Außenhandelsinformationen, Cologne  
BGA, Bundesverband des deutschen Gross- und Aussenhandels, Bonn  
BHF-Bank  
Bronnoysundregistrene, Bronnoysund, Norway  
Bundesanstalt für Arbeit, Nuremberg  
Bundesministerium für Wirtschaft und Arbeit  
Centre d'Observation (COE), Paris  
Chambre de Commerce, Luxembourg  
Department of Trade and Industry, London  
DIHT, Deutscher Industrie- und Handelstag, Bonn  
DIW Deutsches Institut für Wirtschaftsforschung, Berlin  
Institut der deutschen Wirtschaft e. V., Cologne  
Konjunkturforschungsstelle Eidgenössische Technische Hochschule Zürich, Zürich  
Kreditanstalt für Wiederaufbau, Frankfurt/Main  
Organisation für wirtschaftliche Zusammenarbeit und Entwicklung (OECD), Paris  
The Insolvency Service, London  
The World Bank Group, Paris  
US Department of Commerce, Economics and Statistics Administration, Washington D.C.  
WIFO, Österreichisches Institut für Wirtschaftsforschung, Vienna

## **Publications**

Bundesministerium der Finanzen, volks- und finanzwirtschaftliche Berichte  
Creditreform-Analysen  
Deutsche Bundesbank; "Monatsberichte", Frankfurt, 2002  
Various newspaper and magazine articles  
DTI, Department of Trade and Industry UK  
Euler Trade Indemnity, Quarterly Business Review  
Euler Trade Indemnity; Quarterly Financial Trends  
Grant Thornton International; European Business  
Survey, London  
ifo - Wirtschaftskonjunktur  
Institut der deutschen Wirtschaft; "iwd", Cologne, various editions, 2002  
Jahn, U. (Hrsg.): "Insolvenzen in Europa", 3. Aufl., Economica-Verlag, Bonn, 1998  
Koebmandstandens OplysningsBureau A/S, Copenhagen; Quarterly analyses, 2002

## **EU publications**

BACH-Datenbank  
DEBA, Data for European Business Analysis, Luxembourg  
European Commission, 2001  
European Network SME Research  
KMU in Europa – inklusive einer ersten Betrachtung der Beitrittsländer  
Panorama europäischer Unternehmen  
Unternehmen in Europa (sechster Bericht), Eurostat