11 MAY 2021

COFACE ECONOMIC PUBLICATIONS

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By Christiane von Berg
Economist for Northern Europe
based in Mainz, Germany

Germany: More insolvencies in the pipeline

It is not news that insolvencies in Germany dropped significantly by 15.5% in 2020 compared to 2019, although 2020 was marked by the strongest recession in Germany since 2009. Public support programmes, such as loans (which supported around 120,000 companies), state-backed loan-guarantees (for 13 companies) and subsidies around the first lockdown in spring (for 1,775,000 companies) and later on (for 1,838,000 companies) prevented many insolvencies. Furlough schemes were implemented and, during the peak in April 2020, helped 609,681 companies and 5,995,428 employees (or 18% of the labour force). An additional economic support package and changes in the law further helped to prevent insolvencies from happening in 2020.

However, while this is true for the economy overall, not every sector or region could benefit from this development. Indeed, the metals and automotive sectors recorded increases in their insolvencies compared to 2019, by 7% and 32%, respectively. Furthermore, the regional situation was also heterogeneous. While 15 states announced decreasing insolvencies, Bremen stood out as an exception, with an increase of 8.1% compared to 2019. Hesse, Baden-Wuerttemberg and Lower Saxony reported relatively low insolvency decreases too compared to the average. Besides, the year 2020 perfectly displayed that while the numbers of insolvencies did decrease, the damage on the economy increased, as there were fewer but bigger insolvencies in 2020 compared with the previous years. Accordingly, the German statistical office announced that the expected claims connected with the insolvencies in 2020 increased by 65% compared to 2019, reaching EUR 44.1 billion in 2020, the highest level since 2009. Surprisingly, the ICT sector took the top spot, with an increase in expected claims of 2767% compared to 2019, due to a very big insolvency in the pharmacy-IT related services. Hospitality (383% YOY) and "other services" (133%, which include hairdressers and other direct-contact services) came in second and third place. The (retail-)trade-sector announced a 116% increase in claims, while sectors that were not so extremely impacted in their activity by the pandemic, like energy (-97%), transport (-84%) and construction (7%), showed better results.

There are more clouds on the horizon for 2021. While the economy should return to a sustainable recovery in the second half of the year thanks to a mature vaccination progress, higher insolvency numbers are more likely even with the very good financial situation of German companies at the beginning of the recession (better than before the previous recessions in 2002 and 2009). The current lockdown, which has been lasting for already over 5 months, is too extreme for many companies to survive. The early-announced applications for regular insolvency proceedings (Regelinsolvenzverfahren) at courts already increased sharply in February and March. Coface's model shows that there could still be a maximum of 4030 corporate insolvencies in the pipeline, which were "hidden" in 2020 and could materialize in 2021/22. From the corporate perspective, the crisis seems far from over.

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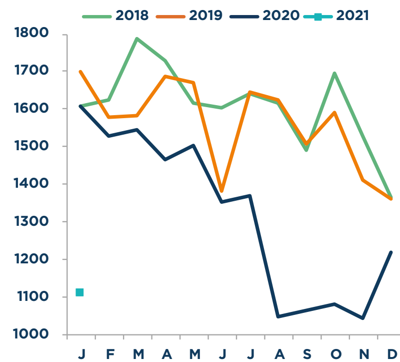
2020 Recap: Insolvencies decreased, but not everywhere

In 2020, 15840 companies went insolvent in Germany. This is the lowest level of insolvencies since 1993, while the yearly decrease in insolvencies (-15.5% compared to 2019) was the strongest since the beginning of the time-series in 1975. Insolvency drops of this magnitude had only been observed in 2007 (-14.6% YoY), right before the international financial crisis, and in 1978 (-14.1% YoY), right before the second oil price shock. In 2020, insolvencies were below the levels of 2019 for every single month. However, the gap between the two years became particularly important from July 2020 onwards **(Chart 1)**. Interestingly, 2021 started as 2020 ended, with very low insolvency numbers. With 1108 corporate insolvencies, the level in January was around that of between August and October 2020. Nevertheless, insolvencies dropped by 31% compared to January 2020.

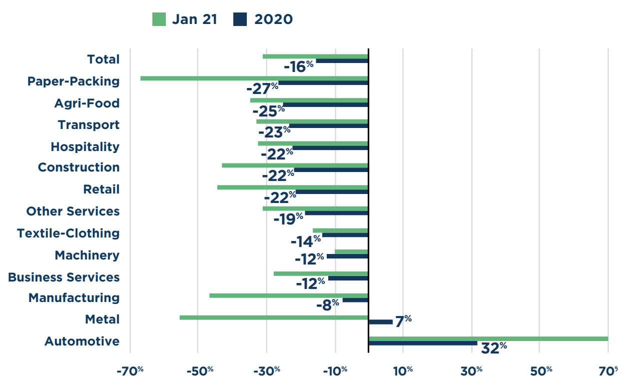
CHART 1
Monthly business insolvencies



Sources: Destatis, Datastream, Coface

However, not every sector or region benefited from this favourable situation. In order to receive State support, companies had to prove that their business model was working before the pandemic, i.e. December 2019. As the automotive and metals sectors had been in recession since late 2018, some companies failed this requirement, did not get state support and went insolvent. The insolvencies in the metals sector increased by 7.1% in 2020, while the increase in automotive reached 31.6% **(Chart 2).**

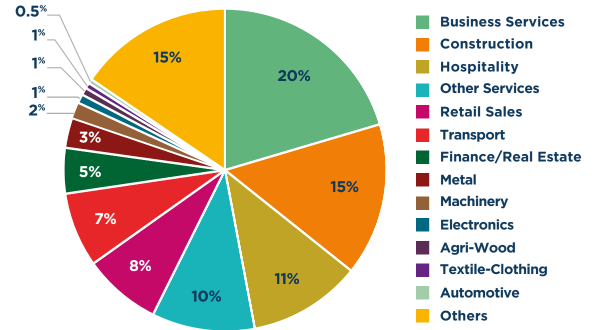
CHART 2
Annual change in the number of insolvencies by sector



Sources: Destatis, Coface

These increases in specific sectors have not changed the overall structure of insolvencies in Germany: the majority of the insolvencies come from business services, construction and hospitality, as well as retail sales and transport **(Chart 3)**. Metals accounted for only 3% of all insolvencies in 2020 and automotive for barely 0.5%.

CHART 3
Breakdown of insolvencies by sector in 2020



Sources: Destatis, Coface

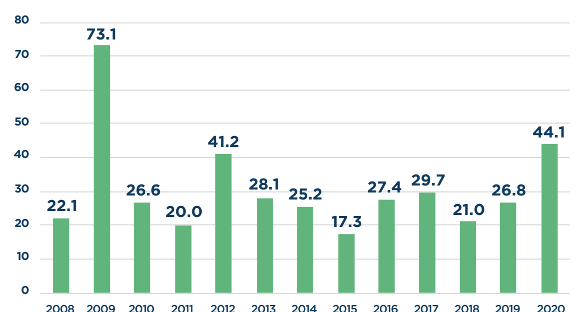
Exceptions were not limited to within the different sectors, but were also observable between regions. Almost every German state ("Bundesland") reported a decrease in insolvencies, except the city/ Bundesland of Bremen. There, insolvencies increased by 8% YoY in 2020, due to higher numbers in business services, manufacturing and transport. The decreases in Hesse (-8.4%), Baden-Wuerttemberg and Lower Saxony (-11.9% each, both automotive states) were noticeably low as well.

Different insolvency developments were also observed between the various corporate legal forms. The use of State support could be an explanation, as it concentrates a lot on small enterprises. In Germany, sole proprietorships contributed by around 25% to the total number of insolvencies while private limited companies (in German GmbH, which are mostly used by SMEs) accounted for 65%. Insolvencies of sole proprietorships dropped by a surprisingly strong 33% in 2020, while the insolvencies of GmbHs decreased by around 7%.

Not all that glitters is gold

From the numbers above, one could think that the situation of German businesses was great in 2020. However, this is a fallacy. The pure number of insolvencies, which are concentrated in very small companies or SMEs, does not give any information on the economic damage. Indeed, the German statistical office (Destatis) estimated that the anticipated claims out of corporate insolvencies added up to EUR 44.1 billion in 2020. In the 12 years since the beginning of the time-series, only one year had higher claims: 2009 with EUR 73.1 billion **(Chart 4)**.

CHART 4
Anticipated claims out of corporate insolvencies in billion Euro



Sources: Destatis, Coface

In 2009, the German GDP fell by 5.7% compared to the previous year (vs. a decrease of 4.9% YoY in 2020), while insolvencies increased by 11.6% YoY (vs. – 15.5% YoY in 2020). In 2020, claims rose by 65% compared to 2019. Some sectors stood out in the comparison. The ICT sector[1] reported an increase of 2767% YoY due to the insolvency of a big prescription clearing office (AVP), with which many pharmacies had worked. The hospitality industry reported an increase in claims of 383% YoY, the trade and retail sector of 116%, and the finance and insurance sector had to deal with an increase of 124%. On the other end of the spectrum, claims in construction only increased by 7% YoY, while claims in transport even fell by 84%.
Therefore, the economic damage in 2020 was high and more insolvencies are in the pipeline. The statistical office reported the preliminary data for standard insolvency proceedings at the courts. Here, the numbers had been dropping since April 2020, but the trend changed in October 2020. Since then, the numbers have been increasing (with a single exception in December). Indeed, the applications for insolvency surged by 30% MoM in February 2021 and by 37% in March, to reach the highest level since March 2017.

Different aspects behind the low number of insolvencies

The main support measures of the federal government

The federal government of Germany implemented several measures to support companies during the pandemic. Loans were used the most during the first year of the pandemic, with a total of almost EUR 49 billion (1.5% GDP, **Table 1**). While the loan program was initially only for medium-sized companies, the range increased with the extension to very small companies at the beginning of the second lockdown in November 2020.
However, the subsidies of the government in the form of emergency aid (during the first lockdown), bridging aid and November/December aid (for the second lockdown) reached the most companies, as they were mostly constructed to help small companies that had been directly impacted by the lockdown rules, e.g. boutiques.

TABLE 1
Approvals and payments of the federal government in billion Euro, status as of 16.03.2021

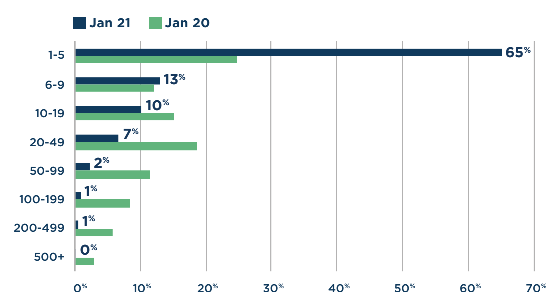
Type	Programme	Company Type	Dates	Number of companies	Sum of approved payments in bn. EUR	Still in progress/audit in bn. EUR
Loans	Kfw-special programme	SMEs, Mittelstand	Mar. 2020 Dec. 2021	120,000	48.8	0.7
Subsidies	Emergency Aid	Small companies, self-employed	Mar. 2020 Jun. 2020	1,775,000	13.6	•
Subsidies	Bridging aids/ Nov.+Dec Aid	SMEs	Jun. 2020 Aug. 2021	1,838,000	14.2	6.1
Recapitalisation	Eco. Stabilisation Fund	Big companies	Mar. 2020 Dec. 2021	13	8.4	•
Guarantees	Protective shield	SMEs	•	•	4.5	•

Sources: Federal ministry of economics, KfW, Association of German Guarantee Banks

A majority of 30% of these subsidies went to the hospitality sector, 12% to "other services" (i.e. hairdressers or cosmetic studios), 10% to trade (especially retail trade), 9% to art, entertainment and recreation and 38% to the others. Interestingly, one of the main pillars, the economic stabilization fund for big companies, was only slightly used. From the EUR 600 billion that were ready to use, only EUR 8.4 billion were mobilized for 13 companies, the largest amounts going to the airline Lufthansa (EUR 5.85 billion) and the travel-company TUI (EUR 1.25 billion).

The focus on SMEs can also be observed in another important support instrument: the furlough scheme (Kurzarbeit). Furlough has a long history in Germany, the current version dating back to 1956. It is particularly important for sectors that are hit by seasonal changes, for instance in the construction sector. However, the rules for the application were relaxed from March 2020 onwards, as the furlough payments increased and the period for payments lengthened. In its numerical peak (in April 2020), a total of 609,681 companies used furlough for 5,995,428 employees, or 17.9% of the regular workforce. Again, the numbers decreased up to October 2020 and increased with the second lockdown in November. During the first and second lockdowns, the hospitality sector had a strong share of furlough (72% in May 2020 and 57% in December 2020), but the latter has decreased, probably because some of the companies closed down. The same can be observed in the retail sector, with a decrease from 16% in May to 7% in December. The payments have flattened too. According to the Ministry of Economic Affairs, furlough payments reached their previous peak in June 2020 with EUR 4 billion per month and stabilized between September 2020 and January 2021 at around EUR 2 billion per month. Between March 2020 and February 2021, a total of around EUR 26 billion was paid in furlough, principally for small and very small companies **(Chart 5)**.

CHART 5
Share of companies with furlough payments by number of employees



Sources: Federal labour agency, Coface

Has the corporate landscape changed?

Technically, another reason for atypically low numbers of insolvencies could be that the corporate landscape had changed: with a lower number of corporations, the number of insolvencies could be lower too. However, a look into the corporation register of the statistical office shows that the total number of corporations has not changed significantly between 2007 (before the previous recession) and 2019 (-0.9%), although numbers could be very volatile within this period. Another aspect could be that, even in these difficult times, companies still manage to close down their business regularly without having to go into insolvency: as it has been the case for insolvencies, the number of regular closures dropped by 11.7% in 2020 compared to 2019, for companies with at least one employee. The numbers have now been declining for five years, but the extent of the decline was exceptional in 2020. Simultaneously, new company creations dropped by 4.8% in 2020. The statistical office named the suspension of visitor traffic and staff shortages within the relevant authorities as one of the main reasons behind these low numbers[2].

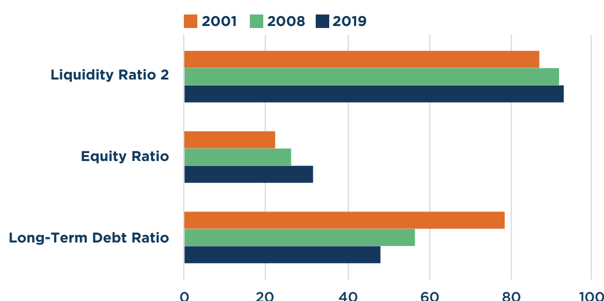
Very good financial position on the eve of the pandemic

The financial position of companies before the crisis is an important aspect when discussing insolvencies due to the pandemic-induced recession. In the April 2020 nadir, the turnover of the corporate sector dropped by 17% compared to the pre-crisis level (as strong decreases in some sectors like hospitality, with a turnover drop of 75%, were partly levelled out by better developments in other sectors such as retail sales).

1 - ICT – Information and Communication Technology
2 - Federal Statistical Office Germany: „4,5% weniger Gründungen größerer Betriebe im Jahr 2020 – Sondereffekte durch Corona Pandemie" (Feb. 2021), https://www.destatis.de/DE/Presse/Pressemitteilungen/2021/02/PD21_062_52311.html.

Even with several support measures from the public sector, it is very likely that these measures were either insufficient or too slow (especially the November and December aid, which took a long time to be paid) to keep the corporate finances in balance. Therefore, the Bundesbank took a closer look at the main indicators of corporate finance right before the large recessions in 2002, 2009 and 2020[3]. The liquidity ratio 2 (quick ratio), which is the ratio of current liquid assets excluding inventories to current liabilities, looks better in 2019 than in 2001 or 2008 **(Chart 6)**.

CHART 6
Corporate financial indicators before the last recessions in %



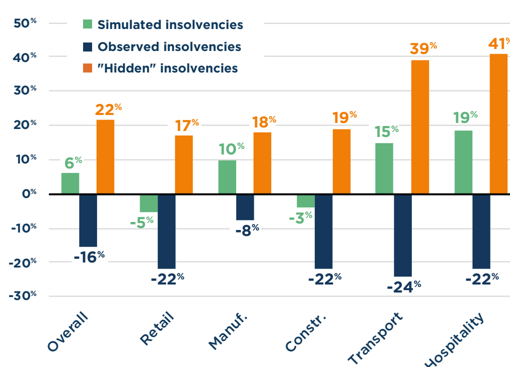
Sources: Bundesbank, Coface

The same is true for the equity ratio and the long-term debt ratio (both a share of the balance sheet total). The numbers show that the German corporate sector was in quite good shape before the pandemic. A liquidity ratio of 100% would be very good, but the level of 93% in 2019 was at least sufficient (SMEs: 85%). The equity ratio of above 30% was very solid (SMEs: 29%) in 2019 and the long-term debt ratio low at 48%. However, this is not the case in all sectors. In terms of the liquidity ratio, sectors such as construction (52%) or retail sales (71%) have low liquidity ratios due to their typically strong inventory. However, low liquidity ratios were also observable before the crises in the pharma-chemicals sector (72%), the metals sector (84%), machinery (87%) and hospitality (88%). The latter three sectors were badly hit during the pandemic. The questions remains as to how much equity there is in order to catch up the financial draught. Construction shows the lowest level in the sample published by the Bundesbank, with 18% in 2019[4]. Hospitality was relatively low as well with 22%, followed by automotive (26%) and retail sales (26%). While construction was not majorly hit by the pandemic, hospitality and retail sales seem like two sectors where the financial buffer is used up and in which more insolvencies are likely, after one 6-week lockdown in spring 2020 and another 5 to 6-month lockdown in winter/spring 2021.

The hidden insolvencies

Last, but not least, there are other legal measures such as the moratorium of the obligation to file in for insolvency, which came into force in March 2020 and ended (at least for the ones receiving the November/ December aid) at the end of April 2021[5]. Furthermore, with the new corporate Stabilization and Restructuring Act (StaRUG), which is in force since January 2021, companies can do a restructuring process before applying for insolvency. These measures have and still will prevent insolvencies from happening in the short-term. In a previous publication[6], we simulated how many insolvencies coming from 2020 would be in the pipeline for the next years, given the turnover situation, the use of furlough, and the use of loans and guarantees. Other support schemes such as bridging aid, the economic stimulus package of the second half of 2020, as well as other support coming from the states, were not included. We focused on the five main sectors (construction, retail sales, manufacturing, hospitality and transport) that represent 53% of all German insolvencies. According to this simulation, total insolvencies should have increased by 6% in 2020 compared to 2019. In reality, insolvencies fell by 15.5%. Therefore, a share of 21.5% (or 4030 insolvencies) represents the maximum (without any other support measures) in the pipeline **(Chart 7)**. The bulk should come from hospitality, where we expect around 660 "hidden insolvencies", followed by transport and construction with around 420 each, manufacturing (230) and retail (190). This shows that even with a low number of insolvencies in 2020, the corporate bill for the pandemic remains open.

CHART 7
2020 results of simulated, observed and total "hidden insolvencies



Sources: Regional Statistical Offices, Coface estimates

3 - German Bundesbank: „Ertragslage und Finanzierungsverhältnisse deutscher Unternehmen im Jahr 2019", monthly report December 2020, p. 71f.
4 - German Bundesbank: "Jahresabschlussstatistik" December 2020.
5 - Status: 05.05.2021
6 - M. Carias, B. De Moura Fernandes, C. von Berg: "The business insolvency paradox in Europe : miracle and mirage", Focus Coface, March 2021

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COFACE SA
1, place Coste et Bellonte
92270 Bois-Colombes
France

www.coface.com

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