THE COFACE ECONOMIC PUBLICATIONS

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coface

Company Insolvencies

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This issue of Panorama contains the results of our Company Insolvency Monitor for April 2012-April 2013. Although the cost of insolvencies continues to rise (+2.7%), the slight dip in number (-0.1%) varies by type of company, with SMEs and MSBs being worst affected. It also ranks sectors of activity by degree of exposure, from which we see that construction, services and automotive continue to be the most at-risk.

This edition also contains the results of a study on insolvencies among Eastern European countries, a region experiencing a sharp rise in the rate of insolvencies (e.g. up 21% in Poland and 10% in Romania in 2012). What reasons are behind the increase which began back in 2007? Have changes in the legal landscape had an effect on insolvencies? What is the role of macroeconomic determinants? Finally, a statistical study provides a forecast for insolvencies in Poland and Romania in 2013.

Insolvency Monitor/Spring 2013

Jennifer Forest, Economic Research Department, Coface

The number of insolvencies levelled out under the 60,000 mark in April 2013, but this figure is still high. In strained economic times, French companies continue to prove themselves the most frail.

The impact of these insolvencies on employment has remained stable (+0.2%) over the twelve months to April 2013, although the cost of insolvency continues to rise (+2.7%). The rate of insolvency during the first quarter of 2013 was particularly high among SMEs (+3.8%).

	Jan - Apr 2013	May 2012 - Apr 2013			
	Number	Number	Cost (€bn)	Cost/GDP	Impact on employment
Insolvencies	20,625	59,630	4.34	0.21%	191,183
Change*	-3.9%	-0.1%	+2.7%	+7.7%	+0.2%

Over the past twelve months, the total number of insolvencies (59,630) has fallen slightly compared to the peak seen in 2009 but remains nonetheless high. This slight fall does vary by type of company. Sole proprietorships are the only ones to experience a decline (-8.2%) whilst commercial enterprises have seen a 3.1% increase (to 44,407) meaning the figure stays high and close to the record of 2009.

For the first four months of 2013, this decrease represents 831 cases compared to the first quarter of 2012, but is unlikely to continue throughout the year.

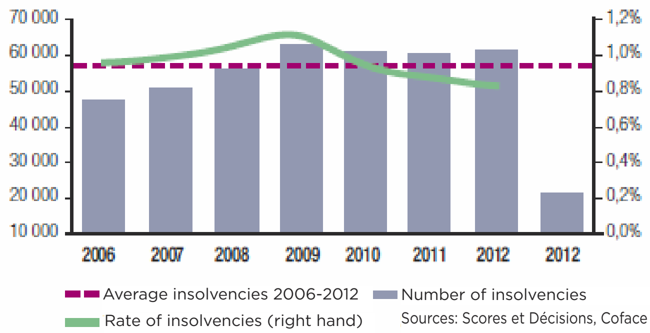
The job losses resulting from these insolvencies have also been levelling out (+0.2%), again since the start of the year. The four cases with the biggest impact in terms of employment were: GAD Sas (1,858 employees; meat conversion and storage), Kem One (1,780), Virgin (1,216) and Domaliance 75 (1,100; home help). They account for 6,000 of the jobs lost.
As for the cost of insolvency, this has continued to rise but to a lesser extent (+2.7%) and remains above the €4 billion mark overall, a significant chunk of GDP (0.21%).

If we look at company size, SMEs (20-249 employees) are the worst hit (insolvencies up 3.7% in just one year) especially the larger among them. The most notable cases are those of VG Goossens, a paperboard manufacturer, and Quinton Hazell France which specialises in wholesale distribution of car parts.

The rate of insolvency among MSBs remains high (43 during the 12 months to the end of April).

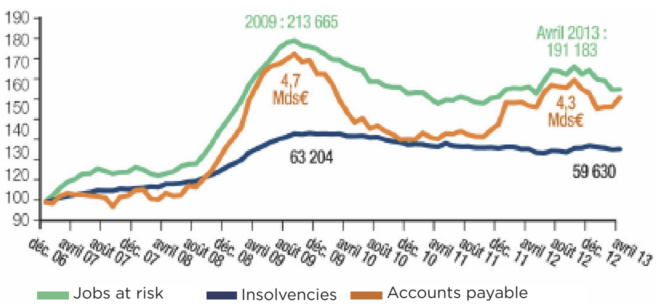
Micro-enterprises which accounted for 93% of all insolvencies in April 2013 have seen a very slight rise (+0.25%) compared to a fall in the VSE sector. From January to April, there was even a 30% fall in VSE insolvencies.

FIGURE 1: Change in number and rate of insolvencies



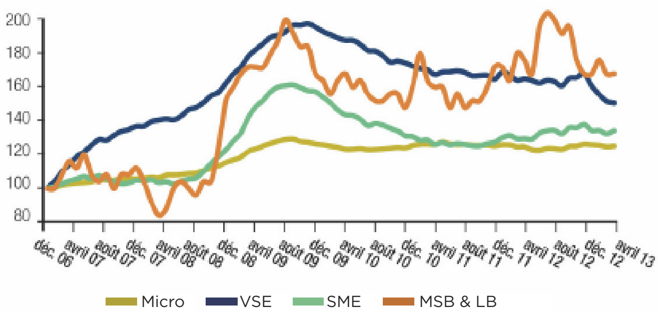
Sources: Scores et Décisions, Coface

FIGURE 2: Change in number and cost of insolvencies
(base 100: December 2006)



Sources: Scores et Décisions, Coface

FIGURE 3: Change in number of insolvencies by company type
(base 100: December 2006)



Sources: Scores et Décisions, Coface

Sector Analysis

The drop in the total number of insolvencies at the end of April does not reflect the situation in every sector. Construction, services for individuals and automotive & transport have not been as lucky. On the other hand there has been a significant fall in insolvencies in the paper/wood sector and food industry.

Sector	Number**	Change**	Share***	Change in cost**	Cost split	Insolvency rate
Construction	19,869	**2.4%**	33%	6.2%	**27.6%**	0.8%
Services to individuals	10,355	**4.4%**	17%	-4.3%	4.8%	1.4%
Other services*	8,556	-6.2%	14%	-11.1%	9.3%	0.5%
Distribution	5,446	-0.6%	9%	56.4%	10.0%	**1.6%**
Automotive and transport	4,008	**3.9%**	7%	**15.9%**	**9.7%**	**2.1%**
Food industry	4,201	-3.8%	7%	**129.9%**	**12.7%**	0.5%
Textiles and clothing	2,124	-2.4%	4%	6.6%	4.6%	1.2%
Electronics and IT/Telecoms	1,781	2.3%	3%	-5.9%	6.7%	1.5%
Paper/Wood	1,607	-15.1%	3%	-30.9%	5.8%	0.4%
Metals	1,077	-0.1%	2%	10.5%	6.7%	**1.6%**
Chemicals	606	-2.7%	1%	**-78.4%**	**2.1%**	1.1%
Total	**59,630**	**-0.1%**	**100%**	**+2.7%**	**100.0%**	**0.8%**

*Services for companies and local authorities
**Over the 12 months from May 2012 to April 2013
***Share: number of insolvencies in the sector/total number of insolvencies

Sources: Scores et Décisions, Coface

At-risk sectors

Construction has experienced a double effect. It accounts for one third of insolvencies in France and its situation worsened between April 2012 and April 2013 (+2.4% in number and +6.2% in cost). These rises went hand-in-hand with an 11.2% fall in new construction start-ups in the first quarter of 2013. The businesses hardest hit are masons (19% insolvencies), painters (7.5%) and electricians (7%).

The service sector continues to suffer, having recorded a notable rise of 4.4%. This was demonstrated by the court-ordered receivership of Domaliance 75 in February 2013 which was badly affected by the reduction in tax benefits for home help.

Distribution saw its insolvencies stabilise in number (-0.6%) but explode in terms of the related costs (+56.4%). This sector has been bearing the burden of both traditional names such as Virgin (file for insolvency in January 2013) and online retailers. Telemarket SA, a subsidiary of Super U since 2011 with a €40 million turnover (2011) defaulted in April 2013.

Automotive and transport continues to be affected by a sustained rate of insolvencies, despite an apparent slowdown since the publication of the last monitor in February 2013. The average trade creditors bill seen with these insolvencies is €105,000. The automotive market is still in free-fall with a 11.7% fall in registrations over the first four months of 2013. Commercial vehicle sales have been particularly affected by the wait-and-see approach of fleet managers when it comes to renewing their stock. At the end of the chain, it is the dealers who are the hardest hit by this slump in demand. Stock is harder to shift, whilst a price war rages on affecting not only their margins but also those of the manufacturers. Pugnac Automobiles fell victim to this and has gone into court-appointed receivership.

Sectors on the ebb

The food industry remains frail and weakened by the insolvencies of the Doux Group and then of Spanghero which went into liquidation in April 2013. The cost of its insolvencies remains high and is still rising (+130%). Bakeries, who are highly vulnerable to the surge in the cost of cereals, account for one quarter of the insolvencies in this sector.

The situation in the **electronics and IT/Telecoms** sector has gotten worse (insolvencies up by 2.3%). The growth of e-commerce and the emergence of low-cost computers have penalised smaller distributors. We note the case of Digger Technologie (€41 million turnover) which has gone into court-appointed liquidation. A downturn in sales of laptops in favour of tablets is causing the market to rethink its economic model.

Chemicals is a highly cyclical sector. We note the “chemicals” component of the industrial production index continues to slide. This is aggravated by the continuing impact of the high cost of oil, used both as a raw material (as naphtha) and in energy production. As for refineries, margins are being squeezed by the high price of Brent, as well as by the competition by finished products from America which benefit from cheap hydrocarbons and higher volumes.

Sectors relatively spared

The textiles and clothing sector has seen a fall in the number of its insolvencies (-2.4%) although the cost is on the rise (+6.6%). Of the SMEs affected, we note Marèse SAS (€25m turnover, 132 employees) which went into court-appointed receivership, as did the group's holding company earlier in the period (whose debt sky-rocketed following a LBO). Concerning clothing, the major chains accumulate most of the sales. The luxury segment is consolidating its growth in the emerging markets. Certain niche markets continue to survive in France such as top-of-the range lingerie brands (Lejaby). We have also seen a small part of the Garella network relocate to France.

The paper/wood sector recorded only a small number of insolvencies (1,607) marking a continued improvement (15.1% fewer this period). However, given the outlook for 2013, the packaging sector is preparing for a downturn in sales, certain companies are likely to be sold off and some of the weaker brands (losses in 2012 and high debt such as Gascogne Laminates) are facing a greater risk of default.

Glossary

Insolvency: insolvency i.e. court-ordered receivership or liquidation
Insolvency rate number of insolvencies in the sector/number of companies in the sector
Sole proprietorships: INSEE legal categories 11 to 19
Micro-enterprises: companies with fewer than 10 employees
MSB: medium-sized business with between 250 and 4,999 employees
Cost of insolvency: total accounts payable of the defaulting companies

Central European countries in crisis: why?

Paul Chollet, Jennifer Forest and Emmanuelle Hirsch, Economic Research Department, Coface

Since the crisis first began in developed countries in 2008, the macroeconomic performance of CEE countries (see box) has been limited, with an annual average growth for the region of 1.2% compared to 5% in emerging markets. This stuttering recovery after the recession of 2009 has affected companies in particular and in nearly all countries we are seeing a much faster rate of default.

To what do we owe this crisis facing East European companies? Have the legal reforms passed in Central and Eastern Europe resulted in a greater number of insolvencies being declared? Is this upturn in the rate of insolvencies due to the Eurozone crisis? Can we draw any links between insolvency and credit flows? To answer these questions we will look at five countries in Central and Eastern Europe: Poland, Romania, Hungary, Czech Republic and Slovakia. But whatever the situation, 2013 will not see an end to the crisis for East European businesses, as can be seen from our insolvency forecasts for the Romanian and Polish markets.

I - OVERVIEW OF INSOLVENCIES IN CENTRAL EUROPE SINCE THE BEGINNING OF THE CRISIS

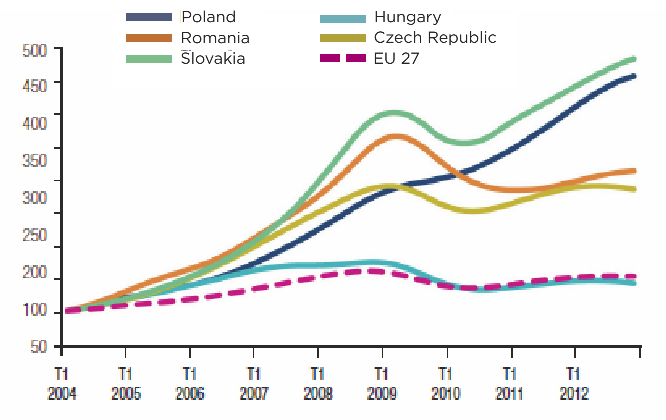
Sharp increase in insolvencies since 2007

In Central Europe the rate of insolvencies rose in 2012 much faster than in Western countries: +7.2% in Slovakia, +21% in Poland and +26.9% in the Czech Republic (Figure 1).

Hungary and Romania reported insolvency rates of 3.8% and 5.7% respectively, i.e. 5-7 times higher than France (0.8%). Poland has reported a record number of insolvencies in 8 years.

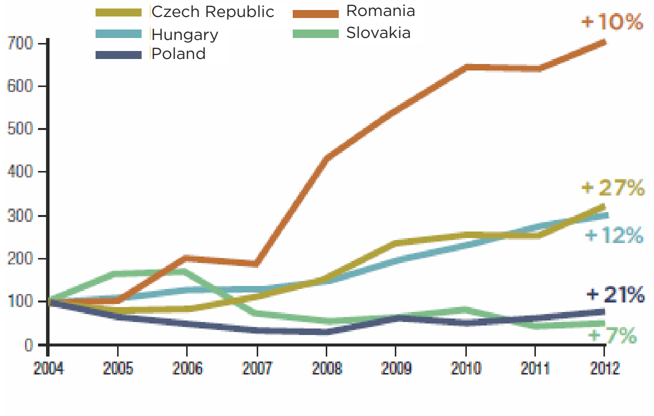
However, these latest increases for 2012 mark an ongoing trend since the number of insolvencies has risen year on year since 2007. With the exception of Slovakia, between 2007 and 2012 the number of insolvencies has at least doubled: +185% in Czech Republic and +267% in Romania.

FIGURE 1: Change in GDP of the biggest economies in Central Europe (2004=100)



Sources: Coface, Central Bank

FIGURE 2: Change in insolvencies since 2004 (2004=100)



Sources: Coface Central Europe, Coface

Definition of CEE (Central and Eastern Europe) used for the study
CEE means Bulgaria, Croatia, Hungary, Poland, Romania, Slovenia, Slovakia, Czech Republic, Macedonia, Kosovo, Serbia and Bosnia Herzegovina. It does not include countries of the CIS or the Baltic States.

Even though most insolvencies in Central Europe, as in the West, are of SMEs and in particular micro-enterprises (85% of defaulting Romanian businesses are micro-enterprises), larger companies have not come through unscathed. In Romania, medium and large enterprises account for 85% of the jobs lost through these insolvencies.

TABLE 1:
The ten biggest insolvencies in Central Europe in 2012

Country	Company	Sector	Workforce
Romania	Hidroelectrica SA	Energy	5243
Poland	Bomi S.A.	Distribution	1748
Romania	Minimax Discount SRL	Distribution	1323
Hungary	Malév Magyar Légiközlekedési Zrt.	Transport	1213
Romania	Confort SA	Construction	956
Poland	Hydrobudowa Polska S.A.	Construction	920
Poland	Poldim S.A.	Construction	550
Slovakia	Metalurg-Immo, s. r. o.	Real estate	550
Hungary	ARZENÁL Kereskedelemfejleszt Kft.	Wholesale	504
Poland	PBG S.A.	Construction	393

Sources: Coface Central Europe, Coface

Moreover, these insolvencies are concentrated mainly in the construction and commercial sectors.

The situation in construction continues to decline. In the Czech Republic in 2012, production fell by 6.5% (continuing the trend since 2008), which explains the high number of insolvencies. Likewise, in Romania, Hungary and Slovakia this sector now accounts for one third of insolvencies. Finally, in Poland, insolvencies in this sector have risen from 10% to 25% of the total figure in two years and are up 53%.

The retail and wholesale sector is also suffering. Poland has been penalised (up 15% in 2012 compared to 2011, the second hardest hit sector) by a concentration of the market, strong competition and a fall in consumer confidence. The situation is also difficult in Slovakia (now the second most at-risk sector) and in Romania where it accounts for 23% of insolvencies.

3 questions for Carole Boisselet,
Division Manager, Arbitration Department, Coface

What are the risks currently facing companies in Central Europe?
In 2012, we saw a deterioration in the payment behaviour of companies in Central and Eastern Europe (especially Poland and Romania) possibly linked to the shrinking of their domestic market and in exports (demand has fallen in Southern Europe, their biggest commercial partners) as well as a drying up of bank credit. Consumer credit is now being funded by suppliers who have taken over from the banks. However, they themselves are dealing with strong competition (especially in the distribution sector) and have had to cope with a fall in demand. It is therefore becoming harder and harder to fund their clients' activities. This means a high risk both for clients and suppliers.

Which sectors are the worst hit?
Closely linked to domestic demand, construction is the sector seeing the highest rate of insolvencies in Central Europe. This is also due to the fact it tends to comprise a large number of small companies. These insolvencies are linked to countries from Central Europe that have the greater need for infrastructure. For example, Polish company PBG benefited from the construction boom created by Euro 2012 but had to cut its margins in order to remain competitive. Competition between the various parties involved in the project became too fierce and generated a number of losses which, together with an explosion in raw material prices, caused the company to default.

Retail has also been badly affected. The Polish case of Bomi SA is indicative of the current trend. Banks refused to renew the credit granted to this large company, which is listed on the Warsaw stock index but whose turnover fell sharply in 2011. Funding economic players has become a source of risk. Large Eastern European companies have little opportunity to recourse their debt by issuing them on the markets.

What is the outlook in terms of risk?
We are seeing the relocation of European construction companies who need to grow fast.

The risk weighing on the Slovakian and Czech economies is the fact that their model has relied on the attractiveness for investors (in particular automotive) thanks to its competitive labour costs. However these countries are now coming under competition from Romania and Bulgaria who are attracting more and more subcontractors from Slovakian companies whose labour costs are twice as high.

Elsewhere we are also seeing companies start to relocate, especially towards South Europe which is becoming more attractive for manufacturers (Renault and Fiat). Will this affect subcontractors from Central Europe? It is still too early to say. But we are certainly witnessing the arrival of a new risk.

II - LEGAL REFORMS: WHAT IMPACT HAVE THESE HAD ON INSOLVENCIES?

The entry of the CEE countries into the European Union (EU) led to changes in their legislation on insolvency proceedings in order to meet European criteria.

European legislation: common framework for national legislations

Council Regulation (EC) N°1346/2000 of 29 May 2000 on insolvency proceedings, which came into force on 31 May 2002, defines the European framework for the scope of the law. This law, also known as the European Insolvency Regulation (EIR), applies to all member countries joining the EU after this date with the exception of Denmark.

Four rules have to be complied:
- the collective nature of the proceedings; (review of all creditors at the same time) ;
- the debtor must be insolvent;
- the debtor must, when proceedings are initiated, divest itself of a portion of its powers;
- appointment of an administrator authorised to manage proceedings and to dispose of the assets of the company.

The main aim of the EIR is to provide a common basis for legislation on insolvency proceedings, to have a universal (cross-border) approach to the law whilst recognising the application of domestic law. The EIR establishes (automatic) recognition of insolvency proceedings in the EU, and applies to any company with its main base in one of the Member States as well as to individuals. The competent court is located where the company undertakes its main business.

However, the admission of the Central European countries to the EU has not resulted in legislative harmonisation. The EIR is not meant to establish a rigid framework. Each country is only required to comply with the provisions of European law. Legislation and practice vary between countries. As the definitions enable non-harmonised statistical data to be obtained, it is not easy to make comparisons between the countries at this stage.

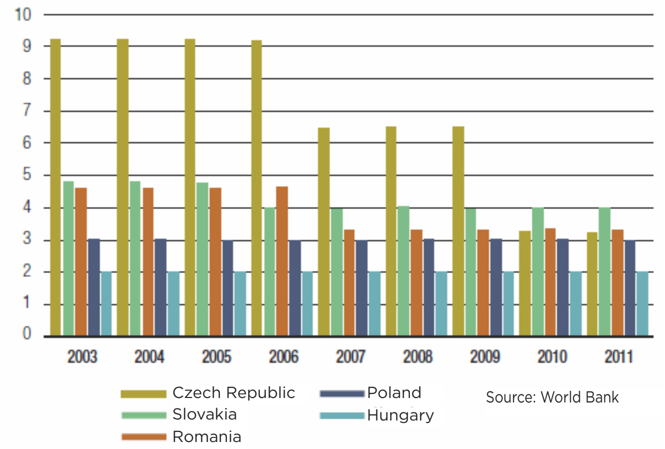
A reduction in the duration of proceedings

On the whole, since their entry into the EU, Hungary, Romania, Poland, Slovakia and the Czech Republic have wanted the duration of their insolvency proceedings to be reduced (see figure 3). The most marked example is the Czech Republic where the duration was down to 3.2 years in 2011 compared to 9.2 in 2003. Since 2000, Hungary has seen its figure remain steady at around 2 years.

This is a result of e.g. entry into the EU for certain countries, the coming into force of new legislation on insolvency and even the delayed effects of previous laws. At the same time, along with the reduction in the duration of proceedings, there has also been a significant increase in applications to initiate insolvency proceedings.

FIGURE 3: Duration (1) of insolvency proceedings

(1) The duration of insolvency proceedings is the time between the application for proceedings to be initiated and the final liquidation of assets.



Glossary

Insolvency: a generic term referring to a company which is subject to collective proceedings and/or a cessation of activity as part of such proceedings. Depending on the country, this may be proceedings involving court-ordered receivership or liquidation.
Insolvency: an insolvent company is no longer in a position to pay off its debts. This is a notion which varies according to country and the term may refer to proceedings.

ROMANIA - HUNGARY

Changes to the legal framework have accelerated insolvencies

These countries have a significant rate of insolvencies, with their companies using the legal means made available to them.

Romania

Proceedings seemed to be used well there. A year before its entry into the EU (2007), it saw the number of company insolvencies double (around 10,000). The introduction of the law on insolvency proceedings (N°85/2006) and its updating in 2010 have enabled a cleaning-up of the business fabric by simplifying proceedings involving the insolvency law. In 2012, there were 23,665 insolvencies. Only a small number of companies choose to reorganise themselves through insolvency proceedings.

A study by Elena Cristina Baciu (Alexandru Ioan Cuza d'Iasi University) shows that the terms "insolvency" and "insolvency" are recent additions to the legislative lexicon of the country. In fact, only through insolvency proceedings can property and business be protected.

Since 2008, Romania has had the largest number of insolvent companies (those which have chosen to use the legal framework made available to them). Thus, in 2010, out of 21,692 bankrupt companies, 10,377 were involved in insolvency proceedings, 5,104 companies and 702 businesses in de facto insolvency, 5,482 insolvency (proceedings leading to liquidation) and 27 were involved in a reorganisation arrangement. One example is the company Hermes Top SRL (food industry), which initiated insolvency proceedings in January 2013 following a fall in its cash flow and its inability to honour its debts. It chose to use reorganisation proceedings to continue its business and submitted a reorganisation plan to the courts which has not been decided yet. This case illustrates the fact that only companies of a certain size choose to use these proceedings. In reality, companies use the provisions for insolvency, in other words those leading to liquidation. Consequently, the law has indeed had an effect on the increase in insolvencies.

Hungary

In 2012, this country registered 22,840 insolvencies, (+11.9% compared to 2011).

In Hungarian terminology, "insolvency" means that the debtor requests assistance to meet its financial commitments in order to ensure its own survival, if possible. In 2009, changes were made accordingly to the law of 1991 (concerning insolvency and insolvency proceedings). The legislator wished to reduce the use of liquidation proceedings, but the law did not have the expected effect. Insolvency (or reorganisation) proceedings are rarely requested by companies. In fact, it is a lot easier to liquidate a company in financial difficulty and to create a new one than to save a company and reorganise it through insolvency proceedings!

POLAND, CZECH REPUBLIC, SLOVAKIA

Recourse still limited to legal proceedings

These countries, however, have seen their number of insolvencies increase but only a small number of businesses (in relation to the total number of active companies) have actually requested insolvency proceedings.

The Czech Republic

In the case of the Czech Republic, in 2012, 7,142 businesses (out of 1,513,556 active companies) went bankrupt (+27% compared to 2011). Despite a law on insolvency which was completely reviewed with unique proceedings for three solutions (reorganisation, debt discharge and insolvency), most proceedings lead to liquidation of the company. The law also created an Insolvency Register which includes the significant points of proceedings.

Poland

The country is characterised by a low number of insolvencies and had a insolvency rate of 0.04% in 2012 (compared to 5.67% in Romania). It registered 877 insolvencies (+21% compared to 2011). In the same year, 166 companies opted for a legal agreement (or for rehabilitation proceedings), an increase of 61% compared to 2011. Rehabilitation proceedings are gradually being put in place, but remain reserved for large organisations. One example is Polbita SA (cosmetic distribution sector) whose parent company belongs to an investment fund. Its banker proposed a rehabilitation plan. If this tendency continues, it will be a strong sign for creditors. Indeed, it must not be forgotten that only some Polish companies make an official application to initiate insolvency proceedings. Proceedings are generally still long and costly. In addition, the available statistics do not take into account directors who liquidate their companies, or those that suspend their business. In fact, it is primarily large organisations that make an application to initiate insolvency proceedings whilst small organisations (including sole traders, SARLs) close their companies down following a default in payment. There has also been an increase in the number of micro-enterprises, in particular self-entrepreneurship. A deepening of the crisis would risk increasing the number of insolvencies in these categories in the long term. The law of 2009 enables entrepreneurs (individuals, legal person) or consumers to initiate insolvency proceedings.

Slovakia

This country also saw an increase in insolvencies in 2012, following the decline in the economic situation. However, although there is an ad-hoc legal framework, lots of over-indebted companies do not apply to initiate insolvency proceedings and prefer simply to cease their business or allocate their company to an unknown individual to avoid proceedings.

In many cases, where legal proceedings exist, they are not used. And even in the case of Romania, where many companies resort to insolvency proceedings, in fact liquidation is given priority.

Generally, in Central Europe the winding up of companies remains predominant, despite legal proceedings supposedly facilitating the restructuring of companies in difficulty. At present, liquidations are not systematically integrated either into official proceedings (Poland) or into statistics. Consequently, the data used may underestimate the exact number of company insolvencies. Some liquidations are "informal": the head of a company closes it down, but the company still remains officially registered. Statistics do not illustrate the full extent of the crisis among companies in Eastern Europe.

Table 2 summarises the different laws that apply to insolvency proceedings in the countries reviewed in this study.

The existence of a suitable legal framework and its adaptation over time may explain the increase in insolvencies in Central Europe. This is not the only explanation, as the economic situation also influences companies.

TABLE 2:
Summary of legislation and proceedings in force in 5 countries of the CEE

	Poland	Romania	Hungary	Czech Republic	Slovakia
Texts in force	Law on Bankruptcy and Rehabilitation of February 2003, important amendment in 2009 which came into force on 2 May 2009	Law on insolvency proceedings N° 85/2006, amended in 2007,2008 and 2009, completed by the law of July 2010. Establishing of an Insolvency Proceedings Bulletin (BPI) identifying all of the actions that have occurred during proceedings.	Bankruptcy and Liquidation Proceedings Act of 20 October 1991, amended in 2009 and in 2011 with implementing decree of 1 March 2012	Insolvency Act N° 182/2006, which came into force on 1 January 2008, amended in 2009 and 2010. Creation of an Insolvency Register identifying the significant points in proceedings	Act N°7/2005 on Bankruptcy and Restructuring of December 2004, which came into force on 1 January 2006, amendment and complement with Act N°348/2011, which came into force on 1 January 2012 (including personal bankruptcies). Separation of the two proceedings, bankruptcy and restructuring.
"Support" proceedings (court-ordered receivership, arrangement or equivalent)	Arrangement: the debtor may remain authorised to perform the actions arising in the ordinary course of events under the supervision or the court monitor, mandatory acceptance of the arrangement by the majority of creditors; Rehabilitation: the debtor is threatened with insolvency but is not yet insolvent, plan must ensure financial recovery of the company and confirm its capacity to become competitive in the market again	Reorganisation with the implementation of a reorganisation plan (prospects for recovery over max. 3 years; acceptance of the plan by creditors); debtor remains in place under the control of an administrator	Bankruptcy (or reorganisation): the debtor requests assistance to meet its financial commitments; aim: to obtain a Memorandum of Understanding, whether negotiated or not; application at the request of the directors	Reorganisation: companies with an annual turnover of at least CZK 100 million or at least 100 employees, directors remain in place under the supervision of an administrator; debt discharge: relates to a natural persons or a consumer	Restructuring: implementation of a recovery plan, the company's management remain in place under the control of an administrator and the court, submission of the plan to the creditor committee and approval by the latter
"Winding-up" proceedings (court-ordered liquidation or equivalent)	Liquidation: at the request of the debtor or one of its creditors	Bankruptcy: at the request of the debtor or the creditor	Liquidation: may be requested by the debtor, by a creditor or by a company registration court ruling; review by the court whether the company is insolvent or not within 60 day of the application being received	Bankruptcy: debtor's assets and company business are undertaken by the insolvency administrator; possible compensation of a registered debt in the statement of liabilities offset against the debtor	Bankruptcy: at the request of the debtor or by at least two creditors
Existence of simplified proceedings	no	Bankruptcy: the debtor enters directly into liquidation proceedings or after a period of observation (max. 50 days)	no	Minimum bankruptcy where debtor is a natural person with a turnover not exceeding CZK 2 million and no more than 50 creditors	"Small bankruptcy": company with a turnover of under €330,000, assets of under €165,000 and fewer than 50 creditors (minimal two conditions)
Existence of "pre-insolvency" proceedings	no	Preventive arrangement: agreement between the debtor and its creditors holding at least 2/3 of its debts; Ad-hoc mandate: confidential agreement, at the request of the debtor under supervision of an authorised representative appointed by the court in order to reach an agreement between the debtor and one or more of its creditors	no	no	no

III - MACROECONOMIC FACTORS: HOW ARE THESE LINKED TO INSOLVENCIES?

TABLE 3: Main macroeconomic aggregates in Central Europe

	At the end of 2012								Coface forecast for 2013		
	Population in thousands	**Degree of economic openness** (exports & imports)/2 /GDP	**Quality of infrastructure** world bank classification 155 countries evaluated	**Hourly cost of workforce** in €, eurostat	**Unemployment rate** eurostat	**Public debt, % GDP**	**Change in debt since 2008**	**Growth 2012**	**Growth 2013**	**Public deficit**	**Public debt**
Poland	38,538	0.46	41	7.4	10.7%	55%	+8 p%	2.0%	1.3%	-4.0%	55.0%
Czech Republic	10,505	0.73	49	10.6	7.2%	43%	+14 p%	-1.2%	-1.9%	-3.3%	45.0%
Slovakia	5,404	0.93	48	8.3	14.5%	52%	+24 p%	2.0%	1.2%	-3.0%	53.0%
Romania	21,356	0.42	87	4.4	6.7%	37%	+23 p%	0.5%	1.2%	-1.8%	37.0%
Slovenia	2,052	0.71	33	14.9	9.9%	53%	+30 p%	-2.2%	-2.8%	-6.0%	65.0%
Hungary	9,958	0.79	39	7.5	11.1%	79%	+6 p%	-1.8%	-0.9%	-4.2%	75.5%
CEE	130,000	0.60	61	7.7	10%	46%	+15 p%	0.7%	0.9%	-	47.0%

To determine why and how insolvencies in Central Europe may vary, let us look at two countries within the zone: Poland and Romania.

We want to explain insolvencies through the components of GDP then through the evolution of credit in the private sector. The figures date back to the time at which the country entered the EU (2004) and therefore does not enable the annual evolution of insolvencies to be regressed by a large number of variables. The analysis is based on private internal demand (ID = private consumption + private investment) and exports. To capture the most significant effects, regressions were also tested for the same variables one quarter later.

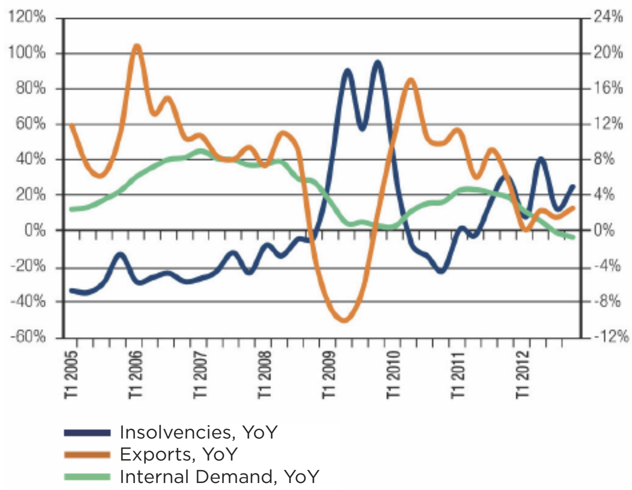
$$\Delta Def_t = \delta + \alpha \Delta DI_t + \beta \Delta X_t + \varepsilon_t$$

(Def represents insolvencies, DI internal demand and X gross exports)

Poland

In Poland, internal/external demands and bank credit correlate with insolvencies.

FIGURE 4: Internal demand, exports and insolvencies



Source: Coface, Datastream, National

Coefficients	Estimate	P value[(1)]
(Intercept)	0.38206	5.2e-06***
Internal demand	-4.80974	0.003397**
Exports	-2.39022	0.000585***

(1) enables the significance of the variables to be verified the p-value is the smallest of the values of α for which the decision would be to reject H0. α is the probability of rejecting hypothesis H0 erroneously; α is also called p-values or test level.

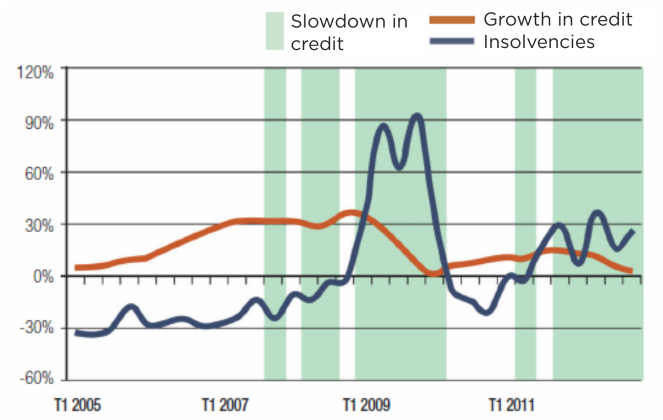
Our model places internal demand as the macro aggregate most commonly responsible for insolvencies. Poland in fact has the largest domestic market in Central Europe according to its size and population.

Exports also correlate significantly with insolvencies. This result is much more unexpected given that the country has opened up much less than its neighbours (46%, see. table 3). Our study relates to companies that have been declared bankrupt. Previously, it was stated that only large companies declare themselves bankrupt. Now, many export companies are large in size. This fact may explain the results from this model.

In 2012 Polish insolvencies increased by 21.3%. The shrinking of the Western Europe economies has slowed down Polish exports (+1.5%) and a rigorous policy designed to control the public deficit has limited internal demand (+0.5%). Since 2004, internal demand has risen at an annual rate of 4.7% and exports by 7.6%. Structurally, when exports and internal demand do not increase over the course of a year, companies' default rate rises by 38%. Consequently, so that insolvencies do not increase in the context of weakening exports (+3% compared to an average of 7.8% since 2004), internal demand needs to grow by 6.5% in one year.

In addition, since 2005 we have noted that fluctuations in credit and insolvencies are connected. Credit exploded in the CEE countries between 2004 and 2008 making private operators (companies and households) very dependent on financing from banks. According to our study statistics, on average, when credit slows down, insolvencies rise by 27%.

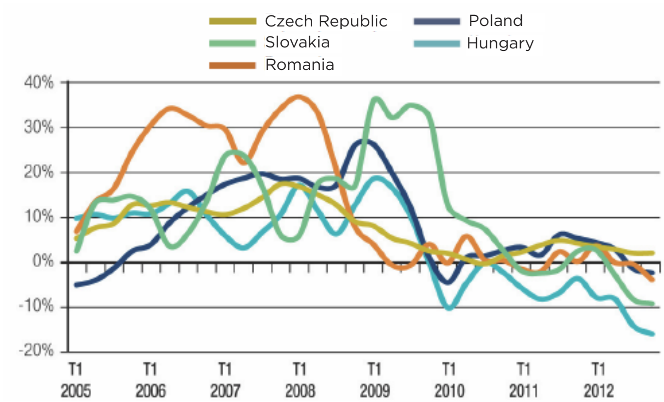
FIGURE 5: Poland, credit and insolvencies.



Source: Coface, Datastream

Coefficients	Estimate	P value
(Intercept)	-0.17991	0.00531**
Credit	0.45071	2.46e-05***

FIGURE 6: Evolution of credit in % GDP, YoY

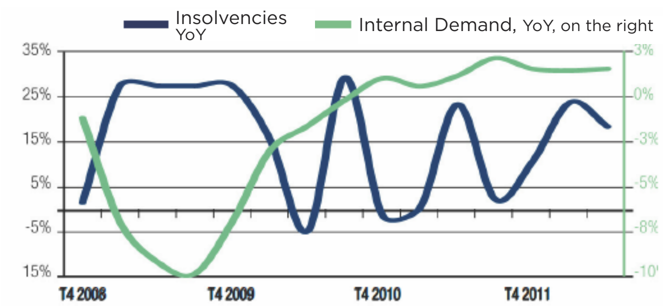


Source: Coface, Datastream

Romania

In Romania, insolvencies correlate with household consumption.

FIGURE 7: Romania, insolvencies and consumption



Source: Coface, Datastream

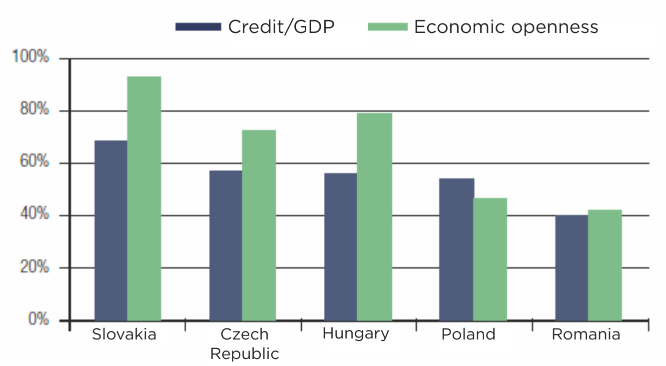
Coefficients	Estimate	P value
(Intercept)	0.12036	0.00214**
Consumption	-1.57975	0.04383*

GDP components do not provide a significant explanation for insolvencies over the period 2004-2008. We can attribute this result to the extensive major legal reforms in 2006 which led to the increase in insolvencies during this period (see. regulatory section). A study over a shorter period Q4 2008-Q4 2012 evidences a link between insolvencies and private consumption.

Exports are not significantly linked to insolvencies, undoubtedly owing to the low economic openness of Romania (42% of GDP, compared to 79% in Hungary and 93% in Slovakia). Only consumption has shown significant correlation with insolvencies in Romania since 2008. This result was expected given that consumption as a percentage of GDP is very high (72%). By way of comparison, this figures is 49% in the Czech Republic – a country driven by exports – and 60% in Poland. The size of the domestic market (21 million inhabitants) means that Romania is the second most populated country in Central Europe and there still exists a very large fabric of individual or family companies in Romania which are more focussed on the domestic market.

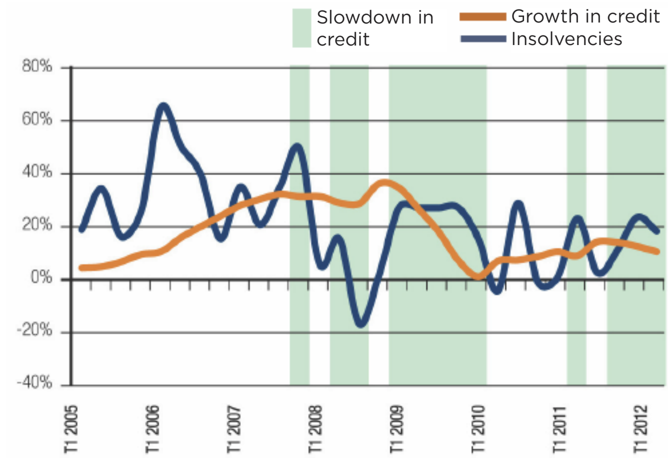
Private consumption grew by 1% in 2012, which was much lower than the level of consumption (7.6%), ensuring that the number of insolvencies remained stable. In addition, there is no obvious connection between the fluctuations, first (growth) or second (slow down), in credit and changes in the number of insolvencies. This result is not surprising in view of the amount of credit in the private sector in the Romanian economy (40% compared to 70% in Slovakia and 54% in Poland).

FIGURE 8: CEEC, credit and economic openness



Source: Coface, Datastream, Central Banks

FIGURE 9: Romania, credit and insolvencies



Source: Coface, Datastream

IV - WHAT IS THE OUTLOOK FOR THE CEE: 2013 FORECAST

In 2013, Coface predicts a renewed increase in insolvencies in Central Europe. According to our model, we believe that this will amount to +10% in Romania and +29% in Poland.

Romania and Poland

At constant prices	Growth 2012	Growth 2013	Consumption YoY	Investment YoY	Private internal demand YoY	**Exports YoY**	Banruptcy YoY
Poland	2.0%	1.3%	1.0%	0.8%	0.9%	2.0%	+29%
Romania	0.5%	1.2%	1.2%	4.2%	1.9%	2.0%	+10%

In Romania, we predict that insolvencies will rise by another 10% in 2013 owing to the weak increase in domestic consumption (+1.2%).
According to our forecasts, in 2013 the volume of Polish exports will increase by 2% and internal demand will rise by 0.9%. Given the very modest rate of growth in these two aggregates, we expect that insolvencies will increase by 29% compared to 2012. As a result of moderate inflation, since November 2012 the governor of the Central Bank has favoured an expansionist monetary policy which promotes consumption and investment. On seven occasions, the Central Bank's reference rate has fallen (-1.75pb). Moreover, in Poland and throughout the whole of Central Europe, private sector credit will again slow down in 2013.

For other countries, whose published figures or statistics have not enabled us to make forecasts, we predict that there will be a significant increase in insolvencies in 2013.

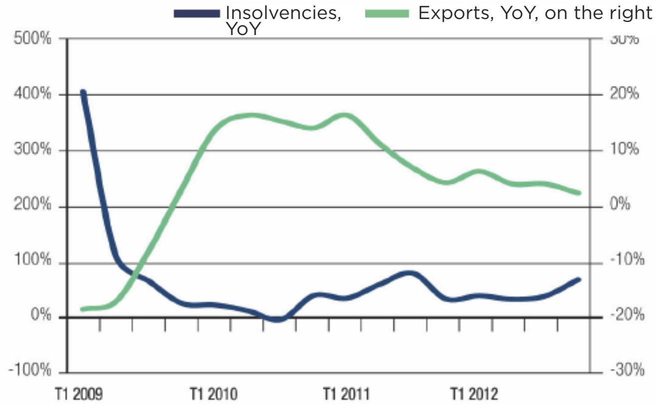
Slovakia

We believe that Slovakia is suffering from serious imbalances (structural unemployment, explosion of public debt, new competition) which will affect companies in the short term. In fact, its model relies on its attractiveness to Western European investors. The country has a skilled workforce, modern infrastructure and an advantageous fiscal policy (a unique tax rate of 19%). However, these benefits are dwindling and the country has seen its public debt increase heavily (52%, +24 p% in 4 years). In order to reassure the European Commission, therefore, Robert Fico's government has introduced a new corporation tax rate (23%), which will enable the deficit to be reduced to 3%. Furthermore, Romania and Bulgaria (who have used structural funds more effectively in developing their infrastructures) attract automotive suppliers and provide fierce competition for Slovakian companies. Labour costs and corporation tax are lower in both countries. In 2013, Slovakian growth will slow down. We predict that the next two years will be difficult and will be marked by a considerable increase in the rate of insolvencies, particularly among suppliers.

The Czech Republic

Macroeconomic fundamentals in the Czech Republic are more stable than those in Slovakia. Nevertheless, in 2013, in line with the recession in Western Europe which according to our forecasts will affect 4 out of 5 of the largest economies (France, Spain, Italy, the Netherlands), the country will once again see a reduction in its GDP. Moreover, the Chinese and Russian economies will slow down in 2013, which will affect exports in the Czech Republic, most notably car exports. In reality, companies will suffer as they have in 2012 from the further opening up of the country (73% of exports). Insolvencies should increase by almost the same amount as in 2012.

FIGURE 10: The Czech Republic, insolvencies and exports



Source: Coface, Datastream

Slovenia

In Slovenia, owing to the fragility of the banking system and with the continued crisis in the Euro zone, we predict that Slovenian companies will be the most affected in Central Europe in 2013. The impact of an agreement with Troika on the increase in insolvencies is difficult to evaluate at this stage. Among the associated conditions, the probable reduction in public subsidies will lead to the disappearance of economic actors who have up until now been supported directly or indirectly by the State.

Although the number of insolvencies has greatly increased in Central and Western Europe in 2012 and will continue to grow in 2013, we cannot attribute the cause of the crisis among Eastern European companies purely to the economic slowdown in Western Europe. Firstly, the reduction in internal demand is the main explanation for insolvencies in Poland and Romania, countries which are relatively closed. In addition, the introduction of new legislation since 2004 has led to a significant increase in applications to initiate insolvency proceedings.

Sources

Coface Central Europe, Central national banks, Datastream, IMF, World Bank, Eurostat, Official Gazette of the European Community.